Supreme Court, U.S.
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No. _____

In The

Supreme Court of the United States

NATIONAL UNION FIRE INSURANCE COMPANY OF PITTSBURGH, PA,

Petitioner,

v.

TERRA INDUSTRIES, INC. AND TERRA NITROGEN (UK) LIMITED,

Respondents.

On Petition For Writ Of Certiorari To The United States Court Of Appeals For The Eighth Circuit

PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED

I. Does a published decision of a United States Circuit Court of Appeals resolving an unsettled question of state law constitute precedent for subsequent diversity cases presenting the same issue in the same circuit? (*See* Pet., Secs. I and II, 9-21.)

II. Can a United States Circuit Court of Appeals decline to follow an applicable rule of decision established by the highest court of a state on an issue of state law? (*See* Pet., Sec. III, 22-23.)

RULE 29.6
CORPORATE DISCLOSURE STATEMENT

Under Supreme Court Rule 29.6, Petitioner, National Union Fire Insurance Company of Pittsburgh, PA ("National Union"), states that its parent corporation is American International Group, Inc. ("AIG"). AIG is a publicly held company that holds one hundred percent of National Union's stock.

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PETITION FOR WRIT OF CERTIORARI

Petitioner, National Union Fire Insurance Company of Pittsburgh, PA ("National Union"), respectfully petitions for a writ of certiorari to review the judgment entered in this case by the United States Court of Appeals for the Eighth Circuit.

OPINIONS BELOW

The opinion of the Eighth Circuit is reported at 346 F.3d 1160 (8th Cir. 2003). (App. 1-10.) The Eighth Circuit affirmed the opinion of the United States District Court for the Northern District of Iowa, which is reported at 216 F. Supp. 2d 899 (N.D. Iowa 2002). (App. 11-52.)

JURISDICTION

The Eighth Circuit entered its judgment on October 17, 2003. National Union then filed a timely petition for rehearing and rehearing *en banc*, which the Eighth Circuit denied on November 20, 2003. (App. 53.)

National Union's petition for writ of certiorari is timely filed under 28 U.S.C. § 2101(c) and Supreme Court Rule 13.3. This Court therefore has jurisdiction under 28 U.S.C. § 1254(1) to review the judgment of the Eighth Circuit on a writ of certiorari.

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

Article III of the United States Constitution contains two sections relevant to the petition. First, "The judicial Power of the United States, shall be vested in one supreme Court, and in such inferior Courts as the Congress may from time to time ordain and establish. The Judges, both of the supreme and inferior Courts, shall hold their Offices during good Behavior." U.S. Const. Art. III § 1. Second, "The judicial Power shall extend . . . to Controversies . . . between citizens of different States." *Id.* § 2, cl. 1.

Also relevant to this case is 28 U.S.C. § 1652:

> **State laws as rules of decision.**
>
> The laws of the several states, except where the Constitution or treaties of the United States or Acts of Congress otherwise require or provide, shall be regarded as rules of decision in civil actions in the courts of the United States, in cases where they apply.

STATEMENT OF THE CASE

None of the relevant facts is in dispute. (*See* App. 12-27 (discussing the facts of the case in detail).)

Respondent Terra Nitrogen (UK) Limited ("Terra UK"), a subsidiary of Respondent Terra Industries, Inc. ("Terra Industries") (Terra Industries and Terra UK are referred to collectively as "Terra"), produces fertilizer by reforming natural gas at a plant in Severnside, England. Carbon dioxide is a byproduct of that process. Terra sells the carbon dioxide to resellers, which in turn sell it to

beverage manufacturers for use in carbonated drinks. (App. 13-14, 16.)

As a result of a leak at Terra's Severnside plant, natural gas containing benzene bypassed the reforming process. In 1998, low levels of benzene were found in beverages incorporating Terra's carbon dioxide. Benzene is a recognized carcinogen at higher concentrations over extended time periods. However, the benzene levels that were found in this case posed no health risk to consumers. (App. 16-17; C.A. App. 27, 40, 394, 563.)

Extensive media coverage prompted beverage manufacturers to recall affected beverages from large wholesalers and grocery store chains. This was done to allay public fears and to protect the manufacturers' reputations. Because the affected beverages posed no health risk, the beverage manufactures did not recall products from smaller retailers or the public. (C.A. App. 204-05.)

Litigation followed in England over the cost of the limited recalls. (App. 17-27.) After a judgment was entered against Terra in one of the English cases, a dispute arose as to whether the commercial umbrella liability insurance policy issued by National Union to Terra (the "Policy") provided Terra with liability coverage for the recall costs.

The Policy provides coverage for "Property Damage . . . caused by an Occurrence." "Property Damage" is defined in the Policy to mean "[p]hysical injury to tangible property." (App. 15.)[1] This definition is a standard term

[1] Other aspects of the definition of Property Damage are not at issue.

found in liability insurance forms developed by Insurance Services Office ("ISO"). The identical definition of Property Damage is found in most general liability insurance policies issued in the United States.[2]

National Union filed this diversity action in the United States District Court for the Northern District of Iowa to resolve the coverage dispute. One of the principal issues raised by National Union was whether the mere incorporation of a defective component into a product constitutes Property Damage within the meaning of the National Union Policy. It is undisputed that Iowa law governs the issue, but neither the Iowa Supreme Court nor the Iowa Court of Appeals has decided the precise question.

Even though the Iowa courts have not resolved the issue, the Eighth Circuit had previously published a decision in a similar case that arose out of Missouri. *Esicorp, Inc. v. Liberty Mut. Ins. Co.*, 266 F.3d 859 (8th Cir. 2001). *Esicorp* addressed whether the mere incorporation of a defective component into a product or system constituted

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[2] This Court has recognized that ISO form contracts are an "important feature[ ] of the insurance industry" and noted that "most [commercial general liability] insurance written in the United States is written on these forms." *Hartford Fire Ins. Co. v. California*, 509 U.S. 764, 772 (1993); *see also IDS Life Ins. Co. v. SunAmerica, Inc.*, 103 F.3d 524, 529 (7th Cir. 1996); *Cincinnati Ins. Co. v. Flanders Elec. Motor Serv., Inc.*, 40 F.3d 146, 149 n.6 (7th Cir. 1994); Nancer Ballard & Peter M. Manus, *Clearing Muddy Waters: Anatomy of the Comprehensive General Liability Pollution Exclusion*, 75 Cornell L. Rev. 610, 621 n.41 (1990) ("Virtually every major American insurance company that issues general liability insurance uses or follows basic ISO form policy language.").

Property Damage within the meaning of a general liability policy. *Id.* at 862-63.[3]

The liability policy interpreted by the Eighth Circuit in *Esicorp* contained the identical definition of Property Damage that is found in the National Union Policy. Following a thorough review of cases decided by courts in other jurisdictions interpreting the same language, the Eighth Circuit held that "there is no 'property damage' unless and until the incorporation of a defective product or component results in 'physical injury to tangible property' in at least some part of the system." *Id.* The Eighth Circuit also predicted that the Missouri Supreme Court would adopt this interpretation. *Id.*

The Eighth Circuit in *Esicorp* rejected what had become known as the "incorporation doctrine." Under that doctrine, the mere incorporation of a defective component into a product or system would be sufficient to show property damage under a liability policy without further proof of physical injury. Before 1971 the incorporation doctrine had a basis in the standard text of liability policies. But after 1971 the definition of Property Damage changed in the standard ISO form of general liability policy, and the change restricted the meaning of Property Damage to physical injury. *Esicorp* held that the change in the definition of Property Damage required something more than mere incorporation of a defective component into a product. In order to constitute Property Damage, there must now be proof of physical injury in some part of the product or system. *Id.*

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[3] The Missouri Supreme Court has not decided this issue.

It is undisputed in this case that the incorporation of the defective carbon dioxide into the beverage products caused no physical injury to the other ingredients – a fact Terra admitted in the trial of the English action. (C.A. App. 344-45.) At no time did Terra offer any evidence that the traces of benzene caused physical injury to the beverages or the beverage ingredients.

The rejection of the incorporation doctrine by the Eighth Circuit in *Esicorp* was a matter of contract interpretation. As such, it was a matter of law. (*See* App. 7-8, 30-31.) National Union relied on the Eighth Circuit's published decision in *Esicorp* as authority for the legal proposition that the mere incorporation of a defective component into a product is insufficient, without evidence of physical injury, to prove Property Damage within the meaning of National Union's Policy.

The district court, however, did not treat the Eighth Circuit's decision in *Esicorp* as precedent. Rather, the district court classified *Esicorp* as one of the cases it considered from "Other Jurisdictions" and gave *Esicorp* no more weight than a decision made by any other court. (App. 39-41.) After reviewing several decisions of other courts, the district court adopted an interpretation of the term "Property Damage" that did not require proof of physical injury to the beverage products. (App. 46.) The district court entered judgment in favor of Terra.

National Union appealed. On appeal, National Union continued to rely on *Esicorp*. Nevertheless, a panel of the Eighth Circuit held that "the incorporation of contaminated carbon dioxide into consumer beverages constituted an 'occurrence' resulting in 'property damage' within the meaning of the policy." (App. 9.) In reaching this decision,

the Eighth Circuit required no proof of physical injury, and none was shown. The Eighth Circuit held in favor of Terra.

The Eighth Circuit made no attempt to distinguish *Esicorp*. In deciding this case, the Eighth Circuit's published opinion did not discuss *Esicorp* at all. Without explaining the conflict with its earlier decision, the Eighth Circuit simply adopted the incorporation doctrine that it had previously considered and rejected in *Esicorp*. As a result, the Eighth Circuit gave neither precedential nor persuasive effect to the reasoning of its earlier published decision on the same issue of law.

REASONS FOR GRANTING THE PETITION

This Court has never addressed the precedential effect within a circuit of a published circuit court decision on an unsettled question of state law. Without this guidance, circuit courts have developed conflicting approaches. *See* Jed I. Bergman, Note, *Putting Precedent in Its Place:* Stare Decisis *and Federal Predictions of State Law*, 96 Colum. L. Rev. 969, 970 (1996) (noting that the "rules governing the binding force of predictive precedents in the federal courts . . . [are] confused and inconsistent"). The uncertainty affects not only decisions made by circuit courts, but also decisions made by district courts. *See* Nikiforos Mathews, Note, *Circuit Court* Erie *Errors and the District Court's Dilemma: From* Roto-Lith *and the Mirror Image Rule to* Octagon Gas *and Asset Securitization*, 17 Cardozo L. Rev. 739, 739-40 (1996) ("the question remains whether district courts are bound by the diversity decisions of their circuit courts, in the absence of state court decisions on point").

The different approaches to this issue can be traced to a deeper problem: an unresolved conflict between the values expressed by *stare decisis* and those expressed by policies connected with the *Erie* Doctrine. *See* Bergman, *supra*, 96 Colum. L. Rev. at 970. "'*Stare decisis,* briefly stated, makes each judgment a statement of the law, or precedent, binding in future cases before the same court or another court owing obedience to its decisions.'" *Northwest Forest Resource Council v. Dombeck*, 107 F.3d 897, 900 (1st Cir. 1997) (quoting 1B James Wm. Moore, et al., *Moore's Federal Practice* ¶ 0.401 (2d ed. 1996)). But the task of federal courts sitting in diversity cases when state law is unclear "is to try to predict how the highest court of that state would decide the question." *Salve Regina College v. Russell*, 499 U.S. 225, 241 (1991) (Rehnquist, C.J., dissenting). The doctrine of *stare decisis* and rules governing *Erie* predictions guide courts in different directions, creating a "conflict between *Erie*'s duty of independent judgment and the deferential doctrine of *stare decisis*." Bergman, *supra*, 96 Colum. L. Rev. at 987.

Review by this Court is necessary to resolve the conflict among the circuits on these fundamental and systemic issues. (*See* Pet., 9-17.) Without a settled rule for federal precedent in diversity cases, the doctrine of *stare decisis,* which is intended to promote continuity and stability, will fall victim to inconsistent application. *See* Bergman, *supra*, 96 Colum. L. Rev. at 987 (recognizing "the need for a uniform approach that accommodates properly the[] competing values" in *Erie* and *stare decisis*).

The doctrine of precedent is "of fundamental importance to the rule of law." *Welch v. Texas Dep't of Highways and Pub. Transp.*, 483 U.S. 468, 494 (1987). It lies at the heart of the federal judicial system. By refusing to give

precedential effect to its decisions predicting state law, the Eighth Circuit has abandoned any notion of the doctrine of precedent in diversity cases. *Peterson v. U-Haul Co.*, 409 F.2d 1174, 1177 (8th Cir. 1969). The Eighth Circuit's view so far departs from the accepted and usual course of judicial proceedings as to call for an exercise of this Court's supervisory power. (*See* Pet., 17-21.)

Finally, the Eighth Circuit in this case failed to follow a rule of applicable state law as established by the Iowa Supreme Court. *Compare* App. 7 (refusing to recognize that the English judgment entered against Terra controls the determination of insurance coverage on the ground that "collateral estoppel does not apply") *with Ide v. Farm Bureau Mutual Insurance Co.*, 545 N.W.2d 853, 858 (Iowa 1996) (as a matter of construction of the liability insurance policy "the judgment actually rendered [against the insured] controls the determination of insurance coverage"). The Eighth Circuit's failure to follow applicable state law is a complete departure from the *Erie* Doctrine and calls for an exercise of this Court's supervisory power. (*See* Pet., 22-23.)

I.

REVIEW IS NECESSARY TO RESOLVE THE CONFLICT AMONG CIRCUIT COURTS ON THE PRECEDENTIAL EFFECT OF FEDERAL COURT PREDICTIONS OF UNSETTLED STATE LAW.

When state law is uncertain, a federal court must make a determination of how the state's highest court would rule. This is known as an "*Erie* prediction," *e.g.*, *Willis v. Roche Biomedical Labs., Inc.*, 61 F.3d 313, 315 (5th Cir. 1995), or an "*Erie* guess," *e.g.*, *Lexington Ins. Co.*

v. Rugg & Knopp, Inc., 165 F.3d 1087, 1092 (7th Cir. 1999). In making these predictions, the circuits have struggled to reconcile the doctrine of precedent with their obligation to anticipate state law. As a result, the formulation of *stare decisis* in diversity cases is far from uniform.

When a state's highest court expressly rejects a federal circuit court's prediction of state law, the federal court's earlier decision is no longer binding precedent for actions in which that state supplies the rule of decision. *See Blackhawk-Central City Sanitation Dist. v. Am. Guarantee & Liab. Ins. Co.*, 214 F.3d 1183, 1193-94 (10th Cir. 2000). This type of case falls squarely within the *Erie* Doctrine. *Erie R.R. Co. v. Tompkins,* 304 U.S. 64 (1938).

Uncertainty has arisen when events other than a subsequent state supreme court decision raise questions about the federal court's earlier *Erie* prediction. This has occurred most often when a lower court within a state questions a federal circuit court's prediction of that state's law. It has also occurred when more subtle changes in the development of a legal principle appear. Under such circumstances, subsequent panels of a circuit court are confronted, on the one hand, with the demands of *stare decisis*, which require fidelity to circuit authority, and on the other hand, with the obligation to make an *Erie* prediction, which may suggest reasons for abandoning the earlier circuit court decision. Based on differing views of the doctrine of precedent and the duty to make an *Erie* prediction, the circuits have adopted conflicting standards that govern when departure from circuit precedent in diversity cases is appropriate.

The Fifth Circuit has adopted a strict formulation of *stare decisis* in diversity cases, which is generally followed

in the Fourth and Tenth Circuits. The Fifth Circuit treats its published opinions predicting state law no differently than its published opinions of federal law. In the Fifth Circuit "[a]dherence to this rule [of *stare decisis*] is no less immutable when the matter determined by the prior panel is the interpretation of state law: Such interpretations are no less binding on subsequent panels than are prior interpretations of federal law." *F.D.I.C. v. Abraham*, 137 F.3d 264, 268 (5th Cir. 1998) (citing *Broussard v. S. Pac. Transp. Co.*, 665 F.2d 1387, 1389 (5th Cir. 1982) (*en banc*)). The Fourth Circuit expressly follows the Fifth Circuit on this issue. *See Derflinger v. Ford Motor Co.*, 866 F.2d 107, 110 (4th Cir. 1989) (citing *Broussard*, 665 F.2d at 1389). The Tenth Circuit has adopted a similarly strict view. *See Koch v. Koch Indus., Inc.*, 203 F.3d 1202, 1231 (10th Cir. 2000).

Strict adherence to circuit precedent is reflected in the obedience to published decisions on unsettled state law even when an earlier decision arose out of a different state. For example, in a case before the Tenth Circuit, the court was required to predict Colorado law on the apportionment of a loss between two insurance policies. The Tenth Circuit found no reason to depart from circuit precedent and "adhere[d]" to its prior decision predicting Kansas law under similar factual circumstances. *State Farm Mut. Auto. Ins. Co. v. Travelers Indem. Co.*, 433 F.2d 311, 313 (10th Cir. 1970) (citing *Employers Mut. Cas. Co. v. MFA Mut. Ins. Co.*, 384 F.2d 111 (10th Cir. 1967)). In a case before the Fifth Circuit that was controlled by Texas law, the court looked to its earlier published cases under Louisiana and Mississippi law that decided a similar

issue. *Smith v. Louisville Ladder Co.*, 237 F.3d 515, 519-20 (5th Cir. 2001).[4]

In the Fifth and Tenth Circuits the standard for departing from circuit precedent is quite stringent. In the Fifth Circuit, a "subsequent panel's obligation to follow [a prior panel's] ruling is not alleviated by intervening decisions of intermediate state appellate courts unless such 'state court decisions . . . are *clearly contrary* to a previous decision of this court.'" *Abraham*, 137 F.3d at 268-69 (quoting *Pruitt v. Levi Strauss & Co.*, 932 F.2d 458, 465 (5th Cir. 1991)) (emphasis in original) (further citation omitted). The Fifth Circuit applies a strong presumption in favor of circuit precedent that can only be overcome by the clear weight of intermediate state court decisions in direct conflict with the Fifth Circuit's state law prediction. *Id.* at 269.

In one case before the Tenth Circuit, the panel observed that two intermediate appellate courts in Oklahoma had criticized an earlier circuit decision predicting Oklahoma law. Nevertheless, a subsequent panel of the Tenth Circuit did not believe they were free to overrule a

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[4] These are examples of judicial reasoning as precedent. *See United States v. Meyers*, 200 F.3d 715, 720 (10th Cir. 2000) ("The precedent of prior panels which . . . [a later panel] must follow includes not only the very narrow holdings of those prior cases, but also the reasoning underlying those holdings"); *Roque-Rodriguez v. Lema Moya*, 926 F.2d 103, 108 (1st Cir. 1991) ("[T]he reasoning of [a prior First Circuit case] compels a similar outcome in the case at bar. And, we are not at liberty to reject that reasoning"); *Equal Employment Opportunity Comm'n v. Atlanta Gas Light Co.*, 751 F.2d 1188, 1191 (11th Cir. 1985) ("For us to adhere to the [Supreme] Court's holding but not its reasoning would violate the rules of precedent which control our decision making processes").

Tenth Circuit decision without approval of the circuit court *en banc*. *Stauth v. Nat'l Union Fire Ins. Co.*, 236 F.3d 1260, 1267 & n.3 (10th Cir. 2001).

The Ninth Circuit's view of its state law predictions is not as strict. While generally holding that it is bound by an earlier panel's predictions of state law, *F.D.I.C. v. McSweeney*, 976 F.2d 532, 535 (9th Cir. 1992), the Ninth Circuit's threshold for departing from its diversity precedent is lower. "'In the absence of a pronouncement by the highest court of a state, the federal courts must follow the decision of the intermediate appellate courts of the state unless there is convincing evidence that the highest court of the state would decide differently.'" *Wolfson v. Watts (In re Watts)*, 298 F.3d 1077, 1083 (9th Cir. 2002) (quoting *Owen ex rel. Owen v. United States*, 713 F.2d 1461, 1464 (9th Cir. 1983)). In other words, the Ninth Circuit reverses the Fifth Circuit's presumption. Panels in the Ninth Circuit may depart from circuit precedent in light of any contrary intermediate state court ruling unless there is convincing evidence that the state supreme court would not do so.

The Seventh and Eleventh Circuits take views similar to the Ninth's. Three-judge panels in those circuits, although generally bound by prior panel decisions, are free to depart from circuit authority predicting state law when presented with a contrary state intermediate appellate court decision. *See L. S. Heath & Son, Inc. v. AT & T Info. Sys., Inc.*, 9 F.3d 561, 574-75 (7th Cir. 1993); *Roboserve, Ltd. v. Tom's Foods, Inc.*, 940 F.2d 1441, 1451 (11th Cir. 1991).

The Sixth Circuit is more willing to depart from its earlier state law predictions. In the Sixth Circuit, a panel

may depart from an earlier circuit state law prediction if there is an "indication by the [state] courts" that the issue would have been decided differently. *Blaine Constr. Corp. v. Ins. Co. of N. Am.*, 171 F.3d 343, 350-51 (6th Cir. 1999). The Second Circuit takes the matter one step further. In the Second Circuit, a panel may depart from one of the circuit's earlier state law predictions if there is "a subsequent decision of a state court or of this Circuit tending to cast doubt on that ruling." *Woodling v. Garrett Corp.*, 813 F.2d 543, 557 (2d Cir. 1987). In the view of the Second Circuit, a departure from circuit precedent can be justified not only by a decision of a state court but also by a decision of the federal circuit court. These views give dominant weight to *Erie* and its policies and little weight to the doctrine of precedent. *See, e.g.*, Mathews, *supra*, 17 Cardozo L. Rev. at 757 (expressing the opinion that "a circuit court's *Erie* 'precedent' is undoubtedly of less value than its non-*Erie* precedent.").

The Third Circuit has expressed conflicting views of the problem. One line of authority in the Third Circuit recognizes that the doctrine of precedent applies to state law predictions made by the circuit. *See, e.g., Ciba-Geigy Corp. v. Bolar Pharm. Co., Inc.*, 747 F.2d 844, 856 (3d Cir. 1984). The other line emphasizes that judges and litigants should view circuit decisions on unsettled state law with utmost reservation. "No one may properly rely upon what we have held as more than persuasive on a question of [state] law so long as the [state] supreme court has not ruled upon that legal question." *Aceto v. Zurich Ins. Co.*, 440 F.2d 1320, 1322 (3d Cir. 1971). *Aceto* suggests that the Third Circuit's *Erie* predictions do not have precedential effect and, at most, are merely persuasive, even in the absence of contrary state authority.

As a result of the intra-circuit conflict, district courts within the Third Circuit give varying weight to Third Circuit predictions of state law. *Compare Largoza v. Gen. Elec. Co.*, 538 F. Supp. 1164, 1166 (E.D. Pa. 1982) ("[I]t is axiomatic that this court is bound by a decision of the Third Circuit predicating Pennsylvania law unless the state supreme court issues a contrary decision or it appears from a subsequent decision of the appellate courts that the court of appeals erred.") *with Carrasquilla v. Mazda Motor Corp.*, 197 F. Supp. 2d 169, 173 (M.D. Pa. 2002) ("The Third Circuit . . . has suggested that the only law that is binding on a federal court is the jurisprudence of the state supreme court, and that even a decision by a federal court of appeals does not bind a district court.").

This leads to the view adopted by the Eighth Circuit, which undoubtedly is the most extreme view taken by any circuit: "In a diversity case neither this Court nor the District Court make any declarations of law. . . . Federal court decisions in diversity cases have no precedential value as state law and only determine the issues between the parties." *Peterson v. U-Haul Co.*, 409 F.2d at 1177. Unlike the other circuits addressing the matter, the Eighth Circuit has no standard for departing from circuit precedent on predictions of state law. The Eighth Circuit has no need for such a standard because the Eighth Circuit does not recognize that its state law predictions are in any sense precedents.

The Eighth Circuit's decision in this case is merely an example of this extreme view. No explanation, and no justification, was necessary for the panel's departure from

the reasoning of *Esicorp*. The published decision of the Eighth Circuit in *Esicorp* simply is not precedent because the decision in *Esicorp* is not law.[5]

By ignoring *Esicorp* – a prior Eighth Circuit case that had decided the same legal issue – the Eighth Circuit's resolution of this case directly conflicts with the Fifth and Tenth Circuits' treatment of their earlier decisions of unsettled state law. *See Smith*, 237 F.3d at 519-20; *State Farm Mut. Auto. Ins. Co.*, 433 F.2d at 313. In addition, the Eighth Circuit's refusal to consider ***any*** if its diversity decisions as precedent on a point of unsettled state law conflicts in principle with every other circuit's recognition that predictions of state law are entitled to have some precedential effect.

The conflict between the Eighth Circuit and the other circuits concerns the fundamental issue of whether circuit decisions on questions of unsettled state law are "precedent." In short, the dispute concerns whether federal predictive diversity decisions are "law."[6]

To date, this Court's decisions have provided only the broadest of frameworks for how a federal court should go about predicting state law. Generally, "state law is to be determined in the same manner as a federal court resolves an evolving issue of federal law: 'with the aid of such light

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[5] N.B., Judge Heaney was on the panel that decided *Peterson v. U-Haul Co.* and the panel that decided this case.

[6] As Judge Easterbrook observed: "To have a theory of precedent is to have a theory of the extent to which judges' acts are law. Yet we do not have such a theory." Frank H. Easterbrook, *Stability and Reliability in Judicial Decisions*, 73 Cornell L. Rev. 422, 422 (1988).

as [is] afforded by the materials for decision at hand, and in accordance with the applicable principles for determining state law.'" *Salve Regina College*, 499 U.S. at 227 (quoting *Meredith v. Winter Haven*, 320 U.S. 228, 238 (1943)) (alteration in *Salve Regina*). An earlier published decision of the circuit is certainly "one of the materials at hand." But this broad charge does nothing to define the unique role circuit precedent should play in a diversity case. Clarification is needed. On review, this Court should resolve the conflict between the circuits, recognize that circuit courts owe some level of reasoned deference to their prior decisions of unsettled state law, and determine what the appropriate standard of deference ought to be. For these reasons the petition should be granted.

II.

BY ABANDONING THE DOCTRINE OF PRECEDENT IN DIVERSITY CASES, THE EIGHTH CIRCUIT HAS SO FAR DEPARTED FROM THE ACCEPTED AND USUAL COURSE OF JUDICIAL PROCEEDINGS AS TO CALL FOR THE EXERCISE OF THIS COURT'S SUPERVISORY POWER.

"The doctrine of *stare decisis* is essential to the respect accorded to the judgments of the Court and to the stability of the law." *Lawrence v. Texas*, ___ U.S. ___, 123 S.Ct. 2472, 2483 (2003). With only one exception, each circuit court that has addressed the issue recognizes that the circuit's *Erie* predictions are precedent. The Eighth Circuit is the only circuit that does not recognize its decisions on unsettled state law as precedent. *Peterson v. U-Haul Co.*,

409 F.2d at 1177.[7] The Eighth Circuit's decision in this case is an example of that approach. This is a complete departure from the accepted and usual course of judicial proceedings.

"[I]t is indisputable that *stare decisis* is a basic self-governing principle within the Judicial Branch, which is entrusted with the sensitive and difficult task of fashioning and preserving a jurisprudential system that is not based upon 'an arbitrary discretion.'" *Patterson v. McLean Credit Union*, 491 U.S. 164, 172 (1989) (quoting Alexander Hamilton, *The Federalist*, No. 78, at 490 (H. Lodge ed. 1888)) (further citation omitted). There is a substantial federal interest in maintaining a jurisprudential system that is not based on arbitrary discretion, regardless of whether the matter before the court involves state or federal law. "*Stare decisis* . . . 'is the preferred course because it promotes the evenhanded, predictable, and consistent development of legal principles, fosters reliance on judicial decisions, and contributes to the actual and perceived integrity of the judicial process.'" *State Oil v. Kahn*, 522 U.S. 2, 20 (1997) (quoting *Payne v. Tennessee*, 501 U.S. 808, 827 (1991)). Parties to diversity cases, no less than parties to federal question cases, expect they will be treated the same as others were treated before them. It is this reasonable expectation that is served by the even-handed, predictable, and consistent development of legal

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[7] One panel of the Third Circuit may have rejected the doctrine of precedent in diversity cases. However, another panel clearly applied the doctrine. Consequently, the Third Circuit's published decisions on the issue are conflicting, and the Third Circuit cannot be squarely identified with either view. (*See* Pet., 14-15.)

principles. And by serving this legitimate expectation, the courts contribute to the actual and perceived integrity of the judicial process.

The doctrine of precedent goes to the very role of the judiciary in the federal system of constitutional government. Judge Richard Arnold has cogently argued that the doctrine of precedent in court decisions distinguishes the function of judge from the function of legislator. *Anastasoff v. United States*, 223 F.3d 898, 901-02 (Richard S. Arnold, J.), *vacated as moot on rehearing en banc*, 235 F.3d 1054 (8th Cir. 2000).[8] Justice Traynor (who was no advocate of strict *stare decisis*) shares this same view: "*Stare decisis* signifies the basic characteristic of the judicial process that differentiates it from the legislative process." Roger J. Traynor, *The Well-Tempered Judicial Decision*, 21 Ark. L. Rev. 287, 290 (1967). There is good reason for this characteristic of the judicial process. It can be seen in the different checks on the powers of the judicial and legislative branches of government.

Subject to constitutional restraints, legislators have the power to change the law in whatever way they wish. That vast lawmaking authority is kept in check by the fact that legislators must stand for reelection at regular intervals and account for their actions to the citizenry. Federal judges, with life tenure, do not account for their decisions in this way. Instead, an important mechanism

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[8] Judge Arnold's panel opinion in *Anastasoff* was vacated as moot after the parties to that case reached a settlement and the government changed its policy. *Anastasoff*, 235 F.3d at 1056. Nevertheless, "*Anastasoff*, while vacated, continues to have persuasive force." *Hart v. Massanari*, 266 F.3d 1155, 1159 (9th Cir. 2001) (Kozinski, J.).

for preventing unfettered use of judicial power (in addition to appellate review) is through adherence to precedent. In exercising the judicial power granted by the Constitution, a circuit court should not be allowed to find the law one way in one case and change the law for no justifiable reason in the next. This may be permissible for representatives or senators, who can be removed from office at the next election, but it should not be permissible for federal judges with life tenure.

Diversity cases involving contract rights should be no exception to the doctrine of precedent. "This Court . . . has acknowledged that *stare decisis* concerns are at their acme in cases involving property and contract rights." *State Oil*, 522 U.S. at 20 (citing *Payne*, 501 U.S. at 828). The use of standardized language in contracts, as in the case of National Union's Policy, makes this concern all the more compelling. The principal purpose of using form contracts is to provide predictability and consistency to commercial relationships.[9] In the absence of controlling state court authority, the default rule in federal courts should promote consistency.[10] Unless there is some justification for charting a

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[9] The Stated purpose of using ISO form language in insurance contracts is to ensure consistency. *See* ISO Line-of-Insurance Programs, at http://www.iso.com/products/2200/prod2201.html (visited January 8, 2004) ("[C]ourt interpretations of standard coverage forms assure consistent treatment of claimants. Once a court determines the meaning of a word, phrase, or clause in a standard coverage form, that interpretation has far more meaning and scope than if every insurer's policy form used different wording for the same idea."). Uniform State statutes present the same considerations. *See Northrop Corp. v. Litronic Indus.*, 29 F.3d 1173, 1178 (7th Cir. 1994).

[10] *See* Guido Calabresi, *Federal and State Courts: Restoring a Workable Balance*, 78 N.Y.U. L. Rev. 1293, 1301 (2003) ("[D]iversity

(Continued on following page)

new course, circuits should follow their own precedent on interpretations of standardized contracts that are unsettled in the relevant state court.

In *Esicorp*, the Eighth Circuit reached its interpretation of standardized contract language based on a historical review of the case law and analysis of the changes made in the form language in 1971. The reasoning relied on by the Eighth Circuit to reach its interpretation in *Esicorp* was independent of its prediction that Missouri would give the language the same interpretation. The Eighth Circuit's reasoning in *Esicorp* would have been respected as precedent if it were found in cases decided in other circuits. It was, however, not respected as such by the Eighth Circuit in this case.

"A judge invariably takes precedent as a starting-point." Traynor, *supra*, 21 Ark. L. Rev. at 290. The Eighth Circuit does not require this essential step in diversity cases. The danger of the Eighth Circuit's approach to diversity cases is that it allows for the rule of *ipse dixit*. This is inconsistent with the constitutional form of government in the United States and the proper exercise of judicial power granted to the federal courts under Article III of the Constitution. As such, it is a complete departure from the accepted and usual course of judicial proceedings. It therefore calls for an exercise of this Court's supervisory power. For these reasons the petition should be granted.

[jurisdiction] has an important unifying effect on the law. Federal courts tend to look to national law in these areas. . . . [H]aving courts that are keenly aware of national law speak about state law does have a unifying effect, which it would be too bad to lose").

III.

BY FAILING TO FOLLOW THE APPLICABLE RULE OF DECISION AS DETERMINED BY THE IOWA SUPREME COURT, THE EIGHTH CIRCUIT HAS SO FAR DEPARTED FROM THE ACCEPTED AND USUAL COURSE OF JUDICIAL PROCEEDINGS AS TO CALL FOR THE EXERCISE OF THIS COURT'S SUPERVISORY POWER.

Finally, there is no question of the obligation of federal courts to follow the applicable state rule of decision in diversity cases. *Erie R.R. Co.*, 304 U.S. at 78. In the courts below, National Union pointed out that under Iowa law liability insurance coverage is necessarily controlled by the judgment entered against the insured. *Ide v. Farm Bureau Mutual Insurance Co.*, 545 N.W.2d at 858. Nevertheless, the Eighth Circuit refused to recognize the binding effect of the English judgment against Terra. This was done for the professed reason that the elements of collateral estoppel were not met. (App. 7.)

The rule in *Ide* unquestionably has no relation to the doctrine of collateral estoppel. Rather, the rule is based on the construction of a standard term found in liability insurance policies, including the National Union Policy. This is not a case in which the Eighth Circuit incorrectly applied Iowa law. This is a case in which the Eighth Circuit refused to follow an applicable state law in a diversity case. The unexcused failure of the Eighth Circuit to carry out its obligation under the *Erie* Doctrine so far departs from the accepted and usual course of judicial proceedings as to call for the exercise of this Court's supervisory power. For this reason, the petition should be granted, the Eighth Circuit's judgment vacated, and the

case remanded with directions to proceed consistently with the *Erie* Doctrine and the rule of decision in *Ide*.

CONCLUSION

The issues raised by the petition go to the proper administration of diversity jurisdiction in the federal courts. Review by this Court is necessary to ensure that the institutional protections afforded by the doctrine of precedent are not lost in diversity cases. It is also necessary to harmonize the circuit courts' treatment of their predictive state law precedent and to make that treatment uniform.

For the foregoing reasons, National Union asks this Court to grant its petition for a writ of certiorari.

Respectfully submitted,

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APPENDIX*

United States Court of Appeals
FOR THE EIGHTH CIRCUIT

No. 02-3280

National Union Fire Insurance Company of Pittsburgh, Plaintiff-Appellant, v. Terra Industries, Inc.; Terra Nitrogen, (UK) Limited, Defendants-Appellees.	* Appeal from the United States District Court for the Northern District of Iowa.
Terra Industries, Inc.; Terra Nitrogen, (UK) Limited, Counter Claimants-Appellees, v. National Union Fire Insurance Company of Pittsburgh, Counter Defendant-Appellant.	

* "Bacardi" is sometimes spelled incorrectly by the courts as "Bicardi" throughout this appendix.

Submitted: June 12, 2003
Filed: October 17, 2003

Before RILEY and HEANEY, Circuit Judges, and ERICKSEN,[1] District Judge.

RILEY, Circuit Judge.

National Union Fire Insurance Company of Pittsburgh (National Union) brought an action against Terra Industries, Inc. and Terra Nitrogen, (UK) Limited (collectively Terra) in federal district court[2] seeking a declaratory judgment defining National Union's obligations to defend and indemnify Terra under a commercial umbrella insurance policy (policy). National Union appeals the entry of summary judgment in favor of Terra. We affirm.

I. BACKGROUND

A. Factual Summary

National Union issued Terra a policy for the period July 1, 1997, to July 1, 2000. The policy provided:

> We will pay on behalf of the Insured those sums in excess of the Retained Limit that the Insured

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[1] The Honorable Joan N. Ericksen, United States District Judge for the District of Minnesota, sitting by designation.

[2] The Honorable Mark W. Bennett, Chief Judge of the United States District Court for the Northern District of Iowa.

> becomes legally obligated to pay by reason of liability imposed by law or assumed by the Insured under an Insured Contract because of Bodily Injury, Property Damage, Personal Injury or Advertising Injury that takes place during the Policy Period and is caused by an Occurrence happening anywhere in the world.
>
> The policy defined "property damage" as:
>
> 1. Physical injury to tangible property, including all resulting loss of use of that property. All such loss of use shall be deemed to occur at the time of the physical injury that caused it; or
>
> 2. Loss of use of tangible property that is not physically injured. All such loss shall be deemed to occur at the time of the Occurrence that caused it.

The policy defined an "occurrence" with respect to property damage as "an accident, including continuous or repeated exposure to conditions, which results in Bodily Injury or Property Damage neither expected nor intended from the standpoint of the Insured." The policy further provided that National Union has the "right and duty" to provide Terra with a defense against any claim or suit for damages against Terra that is covered by the policy. In consideration for the policy, Terra paid National Union a premium in excess of $3.2 million.

Terra operates a chemical plant in Severnside, Bristol, England, and produces fertilizer by reforming natural gas. Carbon dioxide is a byproduct of fertilizer production. Terra sold the carbon dioxide to Messer UK Limited (Messer), Hydrogas Limited, and BOC (collectively resellers). The resellers sold the carbon dioxide to beverage

manufacturers. The beverage manufacturers then incorporated the carbon dioxide into carbonated beverages during their bottling and canning processes. The beverage manufacturers sold their products to wholesale and retail customers.

In May 1998, Terra was notified that benzene was discovered in a test sampling of a carbonated beverage. Terra investigated and discovered a leak in a C-114 Feed Preheater exchanger at the Severnside plant. The leak allowed natural gas containing benzene, a genotoxic carcinogen, to bypass the reforming process and to permeate the carbon dioxide. Before discovering the benzene leak, Terra had sold substantial quantities of carbon dioxide containing low levels of benzene to resellers who resold the carbon dioxide containing benzene to beverage manufacturers, who incorporated the carbon dioxide into their carbonated beverages and sold the now contaminated beverages to wholesale and retail customers. Following notification of the benzene leak, scientific testing, and two days of extensive media attention, the beverage manufacturers initiated a trade recall to retrieve product from large wholesalers and large supermarket chains. Because the low benzene levels posed a negligible health risk to consumers, the beverage manufacturers decided against initiating a consumer recall, fearing such a recall would cause widespread panic.

B. Procedural Summary

After the trade recall, several beverage manufacturers sued Messer and Terra in England's Commercial Court, claiming breach of contract and breach of warranty for supplying carbon dioxide unsuitable for use in consumer

beverages. The beverage manufacturers also brought tort claims in the same lawsuits directly against Terra. Messer filed third-party breach of contract and breach of warranty claims against Terra. Terra, in turn, promptly notified National Union.

At the time this appeal was filed, the High Court of Justice, Queen's Bench Division, Commercial Court, in London, England, had entered two judgments[3] against Messer and Terra, obligating Terra to indemnify the resellers for their liability to the beverage manufacturers. National Union, on behalf of Terra, satisfied the first judgment in the *Britvic* case, but refused to satisfy the second judgment in the *Bicardi-Martini* case, contending Terra sustained only economic loss, with no corresponding physical injury to property. Terra and Messer appealed the judgments, and the Supreme Court of Judicature Court of Appeal dismissed the appeals.

Thereafter, National Union brought this declaratory judgment action in federal district court. Both National Union and Terra filed motions for summary judgment. The district court concluded the benzene contamination of Terra's carbon dioxide, which was later sold and incorporated into carbonated consumer beverages, constituted an "occurrence" under the policy. The district court further

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[3] *Britvic Soft Drinks Ltd. and Bass Brewers Ltd. v. Messer UK Ltd. and Terra Nitrogen (UK) Ltd.*, (1999 Folio No. 841) [2002] 1 Lloyd's Rep. 20, 2001 WL 513121 (QBD) (Comm. Ct.) (May 9, 2001) (*Britvic*); *Bicardi-Martini Ltd. v. Thomas Hardy Packaging Ltd. v. Messer UK Ltd. and Terra Nitrogen (UK) Ltd.*, (1999 Folio No. 1198) [2002] 1 Lloyd's Rep. 62, 2001 WL 1040274 (QBD) (Comm. Ct.) (July 12, 2001) (*Bicardi-Martini*).

concluded the occurrence resulted in "property damage" when the integrated products were rendered unsuitable for human consumption, necessitating recall and destruction. The district court denied National Union's motion for summary judgment and granted Terra's motion for summary judgment. The district court ordered National Union to indemnify Terra for the judgment in the *Bicardi-Martini* case, to pay for Terra's defense of all benzene contamination claims, and to indemnify Terra against any judgment or settlement resulting from the benzene contamination.

C. Issues on Appeal

On appeal, National Union argues the district court erred in holding National Union's duty to indemnify Terra was not determined in *Bicardi-Martini,* which awarded damages only for intangible economic loss. National Union further contends there was no property damage and, alternatively, no property damage was caused by an occurrence. Conversely, Terra argues its right to coverage under the policy is not controlled by the English Commercial Court's ruling that no "direct physical damage to property" occurred, because the policy at issue does not require "direct" injury. Terra further claims the English Commercial Court was never presented with the question of whether Terra's liability to third parties arose from "property damage," as defined by the policy and construed under American coverage law. Finally, Terra contends the benzene contaminated carbon dioxide altered the carbonated beverages of third parties, contaminating the consumer products and rendering them unsaleable, and thereby triggering an occurrence of property damage under the policy.

II. DISCUSSION

A. Standard of Review

We review de novo a district court's rulings on issues of law, including the application of collateral estoppel, *In re Scarborough,* 171 F.3d 638, 641 (8th Cir. 1999), and the interpretation of insurance policy contractual provisions, *United Fire & Cas. Co. v. Fid. Title Ins. Co.,* 258 F.3d 714, 718 (8th Cir. 2001).

B. Collateral Estoppel

Under Iowa law, collateral estoppel applies if (1) the issues in the current and prior actions are identical, (2) the issue was raised and actually litigated in the prior action, (3) the issue was material and relevant to the disposition of the prior action, and (4) the determination was necessary and essential to the prior judgment. *See, Dolan v. State Farm Fire & Cas. Co.,* 573 N.W.2d 254, 256 (Iowa 1998) (issue preclusion). We agree with the district court that the English Commercial Court's interpretation of contractual liability clauses relied on a definition of "property damage" distinct and independent from the definition contained in National Union's policy. The issues are clearly not identical. Therefore, the district court properly determined collateral estoppel does not apply.

C. Policy Interpretation

State law governs the interpretation of insurance policies. *Capitol Indem. Corp. v. Haverfield,* 218 F.3d 872, 875 (8th Cir. 2000). The "[c]onstruction of an insurance policy – the process of determining its legal effect – is a question of law for the court. Interpretation – the process

of determining the meaning of words used – is also a question of law for the court unless it depends on extrinsic evidence or a choice among reasonable inferences to be drawn." *Grinnell Mut. Reins. Co. v. Jungling,* 654 N.W.2d 530, 536 (Iowa 2002) (quoting *A.Y. McDonald Indus. v. Ins. Co. of N. Am.,* 475 N.W.2d 607, 618 (Iowa 1991)). The Iowa courts interpret an insurance policy from the "viewpoint of an ordinary person, not a specialist or expert." *Id.*

As the district court recognized, no Iowa case directly addresses whether a contaminated product sold to third-party manufacturers for incorporation into food or beverages triggers an "occurrence" resulting in "property damage," when the incorporation contaminates the finished food or beverage product and renders it unsuitable for human consumption.[4] We agree with the district court that *Kartridge Pak Co. v. Travelers Indem. Co.,* 425 N.W.2d 687 (Iowa Ct. App. 1988), does not control in this instance. *Kartridge Pak* involved damage to an insured's own meat product caused by a defective deboner, *id.* at 689, as distinguished from this case which involves damages to third-party consumer beverages caused by incorporation of benzene contaminated carbon dioxide.

We have carefully reviewed the policy, briefs, record, and oral arguments, as well as the applicable case law. Most American courts interpreting the same or similar policy language under similar factual scenarios have found an "occurrence" resulting in "property damage." *See Zurich*

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[4] The Supreme Court of Iowa has determined "injury to the environment resulting from contamination by hazardous waste constitutes 'property damage' within the meaning of the CGL policies." *A.Y. McDonald Indus.,* 475 N.W.2d at 624.

Am. Ins. Co. v. Cutrale Citrus Juices USA, Inc., No. 5:00-CV-149-OC-10GRJ, 2002 WL 1433728, at *3 (M.D. Fla. Feb. 11, 2002) (holding "the adulteration of Cutrale's juice, which it sold to Tropicana, was an 'occurrence' . . . [that] resulted in 'property damage' which means 'physical injury to tangible property' when, and to the extent that, the adulterated juice was blended by Tropicana in the regular course of business with Tropicana's other juice products."); *Chubb Ins. Co. of N.J. v. Hartford Fire Ins. Co.*, No. 97CIV.6935LAP, 1999 WL 760206, at *8 (S.D.N.Y. Sep. 27, 1999) (concluding sales of adulterated apple juice to beverage manufacturers constituted "occurrences" causing property damage within meaning of comprehensive general liability policy); *Gen. Mills, Inc. v. Gold Medal Ins. Co.*, 622 N.W.2d 147, 152 (Minn. Ct. App. 2001) (concluding "all risk" policy insured food manufacturer who sustained direct physical loss or damage to its oat products resulting from independent contractor treating oats with FDA unapproved pesticide); *Shade Foods, Inc. v. Innovative Prods. Sales & Mktg., Inc.*, 93 Cal. Rptr.2d 364, 376-77 (Cal. Ct. App. 2000) (holding presence of wood splinters in almonds caused "property damage" within meaning of commercial general liability policy when contaminated almonds were incorporated into nut clusters and cereal products). *See also Thomas J. Lipton, Inc. v. Liberty Mut. Ins. Co.*, 314 N.E.2d 37, 39 (N.Y. 1974) (concluding coverage existed under products liability insurance policies for insured noodle manufacturer's liability to soup manufacturer who incorporated contaminated noodles into packaged soups and pasta products). Finding these cases persuasive, we conclude the incorporation of contaminated carbon dioxide into consumer beverages constituted an "occurrence" resulting in "property damage" within the meaning of the policy.

III. CONCLUSION

We conclude the district court thoroughly analyzed the issues and reached the correct conclusions. Accordingly, we affirm the district court's detailed and well-reasoned opinion and judgment. *See Nat'l Union Fire Ins. Co. of Pittsburgh, Pa. v. Terra Indus. Inc.*, 216 F. Supp.2d 899 (N.D. Iowa 2002). Heeding the advice of Robert Browning that "less is more," we stop here.

IN THE UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF IOWA WESTERN DIVISION

NATIONAL UNION FIRE INSURANCE COMPANY OF PITTSBURGH, P.A.,

Plaintiff,

vs.

TERRA INDUSTRIES, INC. and TERRA NITROGEN (UK) LIMITED,

Defendants.

No. C01-4091-MWB

MEMORANDUM OPINION AND ORDER REGARDING CROSS-MOTIONS FOR SUMMARY JUDGMENT

(Filed Aug. 16, 2002)

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III. CONCLUSION 36

Plaintiff National Union Fire Insurance Company of Pittsburgh, P.A. ("National Union") brings this action for declaratory judgment against its insureds Terra Industries, Inc. ("Terra Industries") and Terra Nitrogen Limited ("Terra Nitrogen") (collectively "Terra" unless otherwise indicated) for a declaration that it has no obligation under a commercial umbrella insurance policy issued by it to indemnify Terra for claims pending in English courts over a benzene contaminated carbon dioxide product sold by Terra Nitrogen in the United Kingdom.

I. INTRODUCTION

A. Procedural Background

Plaintiff National Union filed its complaint in this case on August 16, 2001. On August 31, 2001, defendant Terra filed its answer and a counterclaim in which it asserts claims for breach of contract and declaratory judgment against National Union. Specifically, Terra asserts that National Union has breached a commercial umbrella insurance policy issued by it by failing to pay a judgment entered in an English Court against Terra resulting from the sale of a benzene contaminated carbon dioxide product in Great Britain. Terra also seeks a declaration that National Union has an obligation under the umbrella policy to defend Terra against current and future benzene claims and lawsuits, to fund the costs of any appeals associated with the defense of the benzene claims and to indemnify Terra for all current and any future benzene claims in English courts.

On January 16, 2002, Terra filed a motion for summary judgment. On February 19, 2002, National Union

filed a cross-motion for summary judgment. The parties subsequently filed their respective resistances to the other's motion.

Pursuant to the parties' requests, the court held oral arguments on the parties' respective cross-motions for summary judgment on July 31, 2002. At the oral arguments, plaintiff National Union was represented by John F. Lorentzen and Stephanie L. Marett of Nyemaster, Goode, Voights, West, Hansell & O'Brien, P.C., Des Moines, Iowa, and Eric A. Portuguese of Lester, Schwab, Katz & Dwyer, New York, New York. Defendant Terra was represented by Andrew R. Running of Kirkland & Ellis, Chicago, Illinois, and Jeff W. Wright of Heidman, Redmond, Fredregill, Patterson, Plaza, Dykstra & Prahl, L.L.P., Sioux City, Iowa. The parties have filed thorough and extensive briefs in support of their respective positions. Counsel were exceptionally well prepared for oral argument. The oral arguments were spirited and were of substantial assistance to the court in resolving these difficult issues.

The court turns first to a discussion of the undisputed facts as shown by the record, then to the standards applicable to motions for summary judgment and, finally, to the legal analysis of whether either of the parties are entitled to summary judgment on any of the claims at issue in this litigation.

B. Factual Background

The following facts are undisputed. National Union is a Pennsylvania corporation with its principal place of business in New York. National Union is authorized to transact the business of insurance in Iowa. Terra Industries

is a Maryland corporation with its principal place of business in Iowa. Terra Industries is a manufacturer of fertilizer, nitrogen products and methanol. Terra Nitrogen is an indirect wholly-owned subsidiary of Terra Industries, doing business in the United Kingdom. Terra Nitrogen produces fertilizer in the United Kingdom. A by-product of Terra Nitrogen's fertilizer production is carbon dioxide, which Terra sells for a variety of uses, including the making of beverages.

National Union issued to Terra Industries a commercial umbrella liability insurance policy, policy number BE9325998 ("the National Union Policy"). The policy covered the period of July 1, 1997, through July 1, 2000. Terra has paid more than $3,200,000 in consideration for issuance of the National Union Policy. The National Union Policy covers Terra Nitrogen as a subsidiary of Terra Industries. The National Union Policy lists Terra Industries's address as Sioux City, Iowa, its principal place of business. Approximately twenty-five percent of Terra Industries's sales and production occur in England.

The National Union Policy provides coverage for, among other things, property damage and bodily injury as those terms are defined in the National Union Policy. Specifically, the National Union Policy provides:

> We will pay on behalf of the Insured those sums in excess of the Retained Limit that the Insured becomes legally obligated to pay by reason of liability imposed by law or assumed by the Insured under an Insured Contract because of Bodily Injury, Property Damage, Personal Injury or Advertising injury that takes place during the Policy Period and is caused by an Occurrence happening anywhere in the world.

Terra App. Tab 4 at A-100.

The National Union Policy defines "property damage" as follows:

> 1. Physical injury to tangible property, including all resulting loss of use of that property. All such loss of use shall be deemed to occur at the time of the physical injury that caused it; or,
>
> 2. Loss of use of tangible property that is not physically injured. All such loss shall be deemed to occur at the time of the Occurrence that caused it.

Terra App. Tab 4 at A-105. The National Union Policy defines an "occurrence" with respect to property damage as follows:

> 1. As respects **Bodily Injury** or **Property Damage**, an accident, including continuous or repeated exposure to conditions, which results in Bodily Injury or Property Damage neither expected nor intended from the standpoint of the Insured. All such exposure to substantially the same general conditions shall be considered arising out of one Occurrence.

Terra App. Tab 4 at A-104.

The National Union Policy also provides that National Union has "the right and the duty," subject to the terms and conditions of the policy, to provide Terra with a defense against any claim or lawsuit seeking damages against Terra that is covered by the terms of the National Union Policy. Pursuant to Endorsement Number 23, the National Union Policy provides that Terra has the sole

discretion to choose legal counsel to defend itself against any claim or suit seeking damages against Terra that is covered by the terms of the policy.

On January 1, 1998, Terra acquired a chemical plant in Severnside, Bristol, England, from ICI. The Severnside plant produced fertilizer by reforming natural gas. One of the by-products of the manufacture of fertilizer through the reforming process is carbon dioxide. The carbon dioxide was sold to Messer UK limited, Hydrogas Limited, and BOC limited (collectively "the Resellers" unless otherwise indicated). The Resellers then sold the carbon dioxide to other companies that incorporated the carbon dioxide into carbonated beverages during the bottling of beverages (collectively "the Bottlers" unless otherwise indicated).[1] Some of the Bottlers then sold the beverages to other sellers (collectively "the Beverage Sellers" unless otherwise indicated).

On May 18, 1998, Terra learned that benzene had been discovered in a routine sample of carbonated mineral water being tested for importation to the United States. An investigation disclosed that leaks in a C-114 Feed Preheater exchanger at the Severnside plant had permitted some natural gas, which naturally contains benzene, to bypass the reforming section of the plant, where benzene and other impurities would have been removed. As a result, benzene ended up in the carbon dioxide product produced at the Severnside plant. Numerous tests were

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[1] While the court will refer to the beverage manufacturing process as bottling and to the manufacturers as "the Bottlers," the court notes that the beverages were processed and packaged in both bottle and can form.

conducted to determine the nature and extent of the contamination of carbon dioxide produced by Terra. Although the levels of benzene found in the carbon dioxide did not pose a threat to human life, many of the Bottlers and the Beverage Sellers instituted a recall of their products from distributors and retailers.

The Bottlers and the Beverage Sellers asserted claims against the Resellers who, in turn, asserted claims against Terra, seeking to be held harmless from all fees, costs, expenses and damages in connection with the claims. Most of the Bottlers and Beverage Sellers also asserted direct claims against Terra. Terra promptly notified National Union of these claims. Terra's initial defense costs exhausted its $1,000,000 primary policy with CIGNA.

In January 2001, the first of these cases to go to trial in the High Court of Justice, Commercial Court, Queen's Bench Division, in London, England, was *Britivic Soft Drinks, Ltd. and Bass Brewers Ltd. v. Messer UK Ltd. and Terra Nitrogen (UK) Ltd.*, (Case 1999 Folio No. 841) ("the *Britvic* case"). Bass and Britvic argued that Terra was liable because the carbon dioxide produced by Terra was not acceptable because it contained benzene. On January 31, 2001, while the trial was in progress, National Union agreed to withdraw its reservation of rights to deny coverage, thereby acknowledging it was obligated to provide coverage for any adverse judgement in that case.

On May 9, 2001, Justice Tomlinson issued his bench ruling in the *Britvic* case. Justice Tomlinson provided the following overview of the case:

> This case is concerned with events in 1998, when it was discovered that alcoholic beverages and soft drinks manufactured by U.K. producers including

> Bass and Britvic were contaminated by benzene. Benzene is a carcinogen and its presence in foodstuffs is therefore unwanted, although it may on occasion be present in small and controlled quantities because of its preservative qualities. The benzene here was present inadvertently in uncontrolled quantities, albeit those quantities were not potentially harmful to health. The benzene was in the CO2 used to carbonate the drinks.

Britvic, Case 1999 Folio No. 841 at ¶¶ 5, Terra App. Tab 6 at A-121.

The plaintiffs in the *Britvic* case offered expert testimony from a registered analytical chemist, Dr. Alan Rowley, who, assuming that the carbon dioxide was the source of the benzene, concluded that the carbon dioxide manufactured by Terra had contaminated the beverage products manufactured by the plaintiffs. Dr. Rowley further concluded that the costs involved made removal of the benzene from the beverage products impracticable.

The plaintiffs in the *Britvic* case also offered evidence to support their contention that introduction of carbon dioxide containing benzene into their beverages caused their beverage products to become unsalable and caused them to recall those beverage products. Geoffrey Alan Wadds, Britvic's former technical director, avered that:

> The products were contaminated with a known carcinogen, even though it was not at levels which could be a risk to health and so we could not afford to take the risk of seeing a report in the newspaper the following day saying that Britvic had decided not to withdraw the affected product.

Wadds's Declaration at ¶ 9, Terra App. Tab 9 at A-312. Dr. Frederick White, Bass Brewers's director of quality assurance, similarly opined that:

> Throughout this incident I was concerned both to protect our customers from drinking any products containing levels of benzene above levels recommended by [the Ministry of Agriculture, Fisheries and Food ("MAFF")] and to protect our brands from adverse publicity. Given the threshold levels quoted by MAFF and the World Health Organization, I believe the recall decision was inevitable and the only responsible course of action open to us once we had found levels of benzene of the quoted maxima.

White's Declaration at ¶ 30, Terra App. Tab 9 at A-323.

Justice Tomlinson found that tests regarding the nature and extent of contamination of carbon dioxide produced by Terra showed that: "The results, and their geographical spread, are clearly indicative that substantial quantities of CO2 produced at Severnside and distributed across the country were contaminated." *Britvic*, Case 1999 Folio No. 841 at ¶¶ 33, Terra App. Tab 6 at A-142-43.

Justice Tomlinson further found that there was substantial evidence that the end beverage products produced by Britvic were contaminated with benzene:

> As to the end product the position is equally complicated. However so far as concerns drinks manufactured by Britvic, products were found with up to 42 ppb benzene present in the end product . . . At all events Dr. Rowley found clear evidence correlating high benzene levels in Britvic products with the use of Terra Severnside CO2 . . .

Britvic, Case 1999 Folio No. 841 at ¶ 34, Terra App. Tab 6 at A-143-144.

Justice Tomlinson also found as follows:

> Accordingly I can conclude with some confidence on the basis of the evidence that over the relevant period, March to mid-May 1998, Terra released from its Severnside plant very substantial quantities of CO2 which contained total hydrocarbons very comfortably in excess of 10 ppm measured as methane . . . .I can go further and find with confidence that very substantial quantities of the CO2 released by Terra over the relevant period contained in excess of 10 ppm total hydrocarbons measured as methane where at least 10 ppm of the total hydrocarbon content was accounted for by the presence of benzene alone.

Britvic, Case 1999 Folio No. 841 at ¶38, Terra App. Tab 6 at A-148-49.

Justice Tomlinson concluded that Messer's liability to Bass and Britvic, and therefore whether Terra was liable to Messer, depended on whether the benzene tainted carbon dioxide rendered the beverage products unsalable:

> The starting point is that the CO2 had to be suitable for a food application. Either it was or it was not. I do not think that a reasonable man would consider the CO2 intended for a food application which had been inadvertently contaminated with measurable quantities of a known carcinogen was of a satisfactory standard because one could not reasonably expect the guaranteed exclusion of carcinogens without paying more to the supplier.

Britvic, Case 1999 Folio No. 841 at ¶77, Terra App. Tab 6 at A-171-72.

Justice Tomlinson further found that Terra's benzene contaminated carbon dioxide, when incorporated into the beverages involved in the litigation, made those beverages "unsalable." Specifically, Justice Tomlinson found that:

> Wherever the [maximum acceptable benzene] level is to be set both the amounts of benzene which had been allowed to be present and, of equal if not greater significance, the period over which it had been allowed to be present, ensured that the appropriate level was here on any reasonable view exceeded. This case is not concerned with a breakdown of short duration affecting only a small volume of supply, any impurity in which might if not too gross be diluted out. This case is concerned with sustained supply of CO2 containing what in relative terms are substantial amounts of benzene – substantial because of orders of magnitude greater than the level regarded as permissible by standards since adopted.

Britvic, Case 1999 Folio No. 841 at ¶¶ 91, Terra App. Tab 6 at A-179-180. Justice Tomlinson went on to conclude that:

> I therefore find it impossible to conclude that a reasonable person would regard the CO2 supplied as meeting a satisfactory standard. Customers would not wish to drink products which had inadvertently been contaminated with a measurable quantity of a known carcinogen, notwithstanding the quantity was not harmful to their health. If the manufacturers had not taken steps to satisfy the public that all reasonable measures were being taken to recall the batches

> of production affected all of their production would have very quickly become unsaleable. The affected products themselves were in a real sense unsaleable in the sense that no consumer would knowingly buy them and manufacturers could not as responsible manufacturers be seen to attempt to sell them.

Britvic, Case 1999 Folio No. 841 at ¶92, Terra App. Tab 6 at A-180-81.

In the *Britvic* case, Justice Tomlinson ruled that Terra was liable to Messer and that Messer was liable to the claimants. Messer was found to be liable to the claimants based on breaches of warranties implied by English statutes. Terra, in turn, was found to have breached the express terms of its contract with Messer. Liability on Terra was also imposed based on the same breaches of warranties implied by English statutes that Justice Tomlinson concluded applied to Messer. *Britvic*, Case 1999 Folio No. 841 at ¶¶ 74, 104-105, Terra App. Tab 6 at A-168-170, 190-193. On June 29, 2001, National Union on behalf of Terra Nitrogen made payment to satisfy the judgment entered in the *Britvic* case.

The second of the benzene cases to go to trial in the High Court of Justice, Commercial Court, Queen's Bench Division, in London, England, was *Bicardi-Martini Ltd. v. Thomas Hardy Packaging Ltd. v. Messer UK Ltd. and Terra Nitrogen (UK) Ltd.*, (Case 1999 Folio No. 1198) ("the *Bicardi-Martini* case"). Justice Tomlinson was again the trial judge.

The facts underlying the *Bicardi-Martini* case were largely the same as those at issue in the *Britvic* case. Bicardi-Martini claimed that Terra was negligent in

permitting the carbon dioxide to become contaminated with benzene. Claim Form, *Bicardi-Martini*, Case 1999 Folio No. 1198 at ¶8, Terra App. Tab 8 at A-299. The claimant specifically alleged that:

> In consequence of Terra's negligence aforesaid the relevant carbon dioxide contaminated the beverages in respect of which the Claimant claims damages, damaging the same and rendering them unsuitable for human consumption and/or for sale by the Claimant.

Claim Form, *Bicardi-Martini*, Case 1999 Folio No. 1198 at ¶9, Terra App. Tab 8 at A-300.

By stipulation of the parties, the relevant findings in the *Britvic* case were deemed to be binding in the *Bicardi-Martini* case. In addition, the parties agreed that the evidence from the *Britvic* case would be adopted as evidence in the *Bicardi-Martini* case. As a result, no live witnesses were called in the second trial. Rather, the second trial consisted of arguments by counsel on the legal issues raised in the litigation: a contractual limitation on Messer's liability to the claimants, and Terra's liability in tort to the claimants.

Terra argues that a contractual limitations provision capped Bacardi-Martini's potential recovery at £500,000. The limitation on liability provision stated:

> Subject to any other limitation or exclusion of liability expressed elsewhere in this Contract, the liability of Messer, its employees and Agents to the Customer in respect to personal injury or direct physical damage to property (and loses, costs and expenses directly arising from such injury or damage), whether through negligence or otherwise, shall be limited to £500,000 in respect of

> any one incident, except that nothing in this Contract shall restrict Messer's liability to any injured person or his personal representatives for personal injury or death resulting from negligence.

Bicardi-Martini Judgment, Case 1999 Folio No. 1198 at ¶7, Terra App. Tab 7 at A-251-52. Thus, one issue before the court in the *Bicardi-Martini* case was whether Bicardi-Martini's claims arose from "direct physical damage to property." If, as Terra contended, Justice Tomlinson's ruling in *Britvic*, compelled this result, Terra's maximum exposure would be capped, but if, as the claimants argued, the physical injury was not direct, then no such limitation would apply.

Justice Tomlinson found no direct physical damage to the property and refused to apply the limitation:

> On balance, and not without hesitation, I conclude that Messer's liability to THP is not here in respect of direct physical damage to property. It is some comfort to me to know that that conclusion will, I believe, have absolutely no impact upon the ultimate outcome of the case. Had I concluded that there had been direct physical damage to the property, and that THP's recovery against Messer was restricted to £500,000, I should also consequentially have had to conclude on the basis of the manner in which I was invited to approach this question for the purposes of this case that both Bacardi and THP have a cause of action in tort against Terra pursuant to which they may recover their loss. That conclusion would flow from Terra's acceptance for the purposes of this case that direct physical damage to the product occurred and that Terra owed to THP a duty of care to avoid causing such physical

> damage, that second concession on the assumption that the property in the product was at the time of damage with THP.

Bicardi-Martini Judgment, Case 1999 Folio No. 1198 at ¶29, Terra App. Tab 7 at A-272.

Justice Tomlinson's principal rational for not applying the contractual limitation's provision in the *Bicardi-Martini* case was that the benzene contamination occurred prior to the completion of production of the beverages.[2]

Specifically, Justice Tomlinson offered the following rationale for his decision that the limitations provision did not apply in the *Bicardi-Martini* case:

> Mr. Prynne rightly reminded me of my findings in the Britvic judgment to the effect that the end product was unsaleable in consequence of the introduction of CO2 which inadvertently contained benzene. However, if the reasonable person is asked whether the end product has suffered direct physical damage from the contaminated CO2 his answer ought perhaps be no, because the end product did not exist until after the admixture of the CO2 containing benzene and so therefore it cannot logically have suffered damage from contaminated CO2. Put another way, it cannot therefore be said that the benzene caused direct damage to the Breezer – because the Breezer did not exist when the benzene was introduced

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[2] Justice Tomlinson also suggested that his decision not to apply the limitations provision was due in part to the structure of the limitations clause itself. *Bicardi-Martini* Judgment, Case 1999 Folio No. 1198 at ¶26, Terra App. Tab 7 at A-268.

> into the mixture. The end product here was a product which contained benzene. That end product might I suppose have been damaged had there been, for example, a source of dirt or other contamination to which it was exposed after it had become a finished product but before it was bottled. For example, had there been a defect or breakdown in the bottle washing or bottle preparation unit which caused a batch of bottles to contain a contaminant which rendered the product unsaleable, it would I think probably be appropriate to regard such a case as direct physical damage to the end product.

Bicardi-Martini Judgment, Case 1999 Folio No. 1198 at ¶22, Terra App. Tab 7 at A-263-64.

In the *Bicardi-Martini* case, judgment was entered against Terra. As a result of the judgment, Terra was required to pay in excess of £3,135,117.47 in damages, interest and attorneys' fees. Terra has demanded that National Union pay this judgment on its behalf. In a letter dated August 3, 2001, National Union refused to pay the judgment, and informed Terra that: "the loss suffered was economic in nature and that there was no physical injury to the property." Terra App. Tab 2 at A-036. National Union, however, did agree to pay the fees and costs of Terra's appeal of the *Bicardi-Martini* case. Justice Tomlinson granted Terra leave to appeal the *Bicardi-Martini* decision.

On April 30, 2002, the Supreme Court of Judicature Court of Appeal unanimously dismissed the appeals in both the *Britvic* case and the *Bicardi-Martini* case. In the *Bicardi-Martini* case the court of appeals concluded that the loss suffered by the claimants was not due to direct physical damage to property. Rather, the court of appeals

noted that: The loss arose from uselessness of the finished drinks, and the need for their recall." *Bicardi-Martini* Appeal Judgment, Case No. A3/2001/1385 at ¶8, Nation[al] Union Supp. App. at 421. The court of appeals also found that "[w]hat resulted was not damaged concentrate and water, but a defective new product." *Bicardi-Martini* Appeal Judgment, Case No. A3/2001/1385 at ¶10, Nation[al] Union Supp. App. at 422. The court of appeals concluded that basis for recovery was for economic loss: "a claim for the costs associated with the recall and destruction of a defective product [is regarded] as essentially a claim for economic loss, rather than for direct physical damage to property." *Bicardi-Martini* Appeal Judgment, Case No. A3/2001/1385 at ¶11, Nation[al] Union Supp. App. at 422. The remaining claims and lawsuits against Terra are still pending, with trial dates likely to be scheduled in 2002.

II. LEGAL ANALYSIS

A. Standards For Summary Judgment

This court has considered in some detail the standards applicable to motions for summary judgment pursuant to Federal Rule of Civil Procedure 56 in a number of prior decisions. *See, e.g., Swanson v. Van Otterloo*, 993 F. Supp. 1224, 1230-31 (N.D. Iowa 1998); *Dirks v. J.C. Robinson Seed Co.*, 980 F. Supp. 1303, 1305-07 (N.D. Iowa 1997); *Laird v. Stilwill*, 969 F. Supp. 1167, 1172-74 (N.D. Iowa 1997); *Rural Water Sys. #1 v. City of Sioux Ctr.*, 967 F. Supp. 1483, 1499-1501 (N.D. Iowa 1997), *aff'd in pertinent part*, 202 F.3d 1035 (8th Cir. 2000), *cert. denied*, 531 U.S. 820 (2000); *Tralon Corp. v. Cedarapids, Inc.*, 966 F. Supp. 812, 817-18 (N.D. Iowa 1997), *aff'd*, 205 F.3d 1347 (8th Cir. 2000) (Table op.); *Security State Bank v. Firstar Bank Milwaukee, N.A.*, 965 F. Supp. 1237, 1239-40

(N.D. Iowa 1997); *Lockhart v. Cedar Rapids Community Sch. Dist.*, 963 F. Supp. 805 (N.D. Iowa 1997). Thus, the court will not consider those standards in detail here. Suffice it to say that Rule 56 itself provides, in pertinent part, as follows:

> Rule 56. Summary Judgment
>
> (a) For Claimant. A party seeking to recover upon a claim, counterclaim, or cross-claim or to obtain a declaratory judgment may, at any time after the expiration of 20 days from the commencement of the action or after service of a motion for summary judgment by the adverse party, move with or without supporting affidavits for a summary judgment in the party's favor upon all or any part thereof.
>
> (b) For Defending Party. A party against whom a claim . . . is asserted . . . may, at any time, move for summary judgment in the party's favor as to all or any part thereof.
>
> (c) Motions and Proceedings Thereon. . . . *The judgment sought shall be rendered forthwith if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to judgment as a matter of law.*

FED. R. CIV. P. 56(a)-(c) (emphasis added). Applying these standards, the trial judge's function at the summary judgment stage of the proceedings is not to weigh the evidence and determine the truth of the matter, but to determine whether there are genuine issues for trial. *Quick v. Donaldson Co.*, 90 F.3d 1372, 1376-77 (8th Cir.

1996); *Johnson v. Enron Corp.*, 906 F.2d 1234, 1237 (8th Cir. 1990). An issue of material fact is genuine if it has a real basis in the record. *Hartnagel v. Norman*, 953 F.2d 394 (8th Cir. 1992) (citing *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574, 586-87 (1986)). As to whether a factual dispute is "material," the Supreme Court has explained, "Only disputes over facts that might affect the outcome of the suit under the governing law will properly preclude the entry of summary judgment." *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 248 (1986); *Beyerbach v. Sears*, 49 F.3d 1324, 1326 (8th Cir. 1995); *Hartnagel,* 953 F.2d at 394. If a party fails to make a sufficient showing of an essential element of a claim with respect to which that party has the burden of proof, then the opposing party is "entitled to judgment as a matter of law." *Celotex Corp. v. Catrett*, 477 U.S. 317, 323 (1986); *In re Temporomandibular Joint (TMJ) Implants Prod. Liab. Litig.*, 113 F.3d 1484, 1492 (8th Cir. 1997). In reviewing the record, the court must view all the facts in the light most favorable to the nonmoving party and give that party the benefit of all reasonable inferences that can be drawn from the facts. *See Matsushita Elec. Indus. Co.*, 475 U.S. at 587; *Quick*, 90 F.3d at 1377 (same). With these standards in mind, the court turns to consideration of the parties' cross-motions for summary judgment.

B. General Insurance Principles

Because the issue of Nation[al] Union's duty to indemnify Terra in the underlying English lawsuits requires an analysis of whether the claims in those English lawsuits involve "property damage," as defined in National Union's umbrella policy, the court must determine whether the definition of "property damage" is ambiguous as it is

worded in the policy. The question of whether any term in an insurance policy is ambiguous must be determined by the standards for determination of the ambiguity of terms in an insurance contract. The court therefore will review those standards for determining ambiguity.[3]

The standards for determination of the ambiguity of terms in an insurance contract were summarized by the Iowa Supreme Court in *Morgan v. American Family Mut. Ins. Co.*, 534 N.W.2d 92 (Iowa 1995):

> The construction and interpretation of an insurance policy is a question of law for the court to decide. *Johnson v. Farm Bureau Mut. Ins. Co.*, 533 N.W.2d 203, 206 (Iowa 1995). The policy is to

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[3] The parties agree that the court need not make a determination as to a choice of laws in this case because there is no conflict between Iowa and New York law on the issues raised by the parties' cross-motions for summary judgment. The court agrees that there is no "true conflict" between the law of Iowa and the law of New York as to the issues before the court on the parties' cross-motions for summary judgment and therefore the court need not make a choice of law decision. *See Phillips v. Marist Soc'y*, 80 F.3d 274, 276 (8th Cir. 1996) ("[B]efore entangling itself in messy issues of conflict of laws a court ought to satisfy itself that there actually is a difference between the relevant laws of the different states."); *Nesladek v. Ford Motor Co.*, 46 F.3d 734, 736 (8th Cir. 1995) (first question was whether there was a "true conflict of laws," and where there was no doubt that case presented a "true conflict," court turned to consideration of which jurisdiction's law should apply under Minnesota conflict-of-laws rules); *Cleary v. News Corp.*, 30 F.3d 1255, 1265 (9th Cir. 1994) (court must first determine whether "true conflict" exists between the laws of the jurisdictions); *Harlan Feeders, Inc. v. Grand Labs., Inc.*, 881 F. Supp. 1400, 1405 (N.D. Iowa 1995) (noting that before any choice of law need be made, there must be a "true conflict" between the laws of the possible jurisdictions on the pertinent issue). Therefore, the court will apply Iowa law in addressing the issues raised by the parties' cross-motions for summary judgment.

> be construed as a whole, giving the words used their ordinary, not technical meaning to achieve a practical and fair interpretation. *Gracey v. Heritage Mut. Ins. Co.*, 518 N.W.2d 372, 373 (Iowa 1994). When the terms of an insurance policy are ambiguous, we will construe them against the insurer. *Id.* However, the mere fact that the parties disagree on the meaning of a particular term does not establish ambiguity. *Id.* We will not give a strained or unnatural reading to the words of the policy to create ambiguity where there is none. *West Trucking Line, Inc. v. Northland Ins. Co.*, 459 N.W.2d 262, 263 (Iowa 1990).

Morgan, 534 N.W.2d at 99. The standards stated in *Morgan* are mirrored in innumerable decisions by Iowa courts. *See, e.g., Iowa Comprehensive Petroleum Underground Storage Tank Fund Board v. Federated Mut. Ins. Co.*, 596 N.W.2d 546, 550 (Iowa 1999); *LeMars Mut. Ins. Co. V. Joffer*, 574 N.W.2d 303, 306-307 (Iowa 1998); *AMCO Ins. Co. v. Rossman*, 518 N.W.2d 333, 334 (Iowa 1994) (holding that policy terms given ordinary meaning as reasonable person would understand them, and disagreement between parties over meaning does not establish ambiguity); *Farm Bureau Mut. Ins. Co. v. Sandbulte*, 302 N.W.2d 104, 108 (Iowa 1981) (holding that disagreement between parties as to terms meaning does not establish ambiguity); *Pappas v. Bever*, 219 N.W.2d 720, 721 (Iowa 1974) (concluding that terms must be given their plain and ordinary meanings); *Tom Riley Law Firm, P.C. v. Tang*, 521 N.W.2d 758, 759 (Iowa Ct. App. 1994) (disagreement of parties as to meaning does not establish ambiguity and terms must be given their ordinary meaning).

In addition to the standards set out in *Morgan*, a few other points regarding determinations of ambiguities in

insurance contracts need to be mentioned. Under Iowa contract law, "'[a]n ambiguity exists if, after the application of pertinent rules of interpretation to the policy words, a genuine uncertainty exists as to which of two or more meanings is the proper one.'" *Joffer*, 574 N.W.2d at 306 (quoting *Ferguson v. Allied Mut. Ins. Co.*, 512 N.W.2d 296, 298 (Iowa 1994)); *Jensen v. Jefferson County Mut. Ins. Ass'n*, 510 N.W.2d 870, 871 (Iowa 1994) (quoting *Connie's Constr. Co., Inc. v. Fireman's Fund Ins. Co.*, 227 N.W.2d 207, 210 (Iowa 1975)); *Motor Club of Iowa Ins. Co. v. Iowa Mut. Ins. Co.*, 508 N.W.2d 634, 636 (Iowa 1993); *A.Y. McDonald Indus., Inc. v. Insurance Co. of N. Am.*, 475 N.W.2d 607, 619 (Iowa 1991); *Iowa Fuel & Minerals v. Board of Regents*, 471 N.W.2d 859, 863 (Iowa 1991); *Nepstad Custom Homes Co. v. Krull*, 527 N.W.2d 402, 405 (Iowa Ct. App. 1994); *Tom Riley Law Firm, P.C.*, 521 N.W.2d at 759 (noting that ambiguity exists when a genuine uncertainty exists over two or more meanings of the terms of the contract). The test for ambiguity is an objective one: "Is the language fairly susceptible to two interpretations?" *Joffer*, 574 N.W.2d at 308 (citing *A.Y. McDonald Indus., Inc.*, 475 N.W.2d at 619); *Met-Coil Sys. Corp. v. Columbia Casualty Co.*, 524 N.W.2d 650, 658 (Iowa 1994) (same standard) (citing *North Star Mut. Ins. Co. v. Holty*, 402 N.W.2d 452, 454 (Iowa 1987)); *Cincinnati Ins. Co. v. Hopkins Sporting Goods, Inc.*, 522 N.W.2d 837, 839 (Iowa 1994) (same standard); *Iowa Fuel*, 471 N.W.2d at 863; *North Star Mut. Ins. Co. v. Holty*, 402 N.W.2d 452, 454 (Iowa 1987) (same standard); *Sandbulte*, 302 N.W.2d at 108 (same standard); *see also Farm & City Ins. Co. v. Anderson*, 509 N.W.2d 487, 491 (Iowa 1993) (formulating the test for ambiguity in an insurance policy as "whether a reasonable person would read more than one meaning into

the words," citing *Smithway Motor Xpress, Inc. v. Liberty Mut. Ins. Co.*, 484 N.W.2d 192, 194 (Iowa 1992)).

It is a "fundamental rule" for interpreting insurance policies that when the meaning of a term in an insurance policy is ambiguous, it must be construed in the light most favorable to the insured. *Cincinnati Ins. Co.*, 522 N.W.2d at 839; *AMCO Ins. Co.*, 518 N.W.2d at 334 ("When the meaning of terms of an insurance policy is susceptible to two interpretations, the one favoring the insured is adopted."); *Jensen*, 510 N.W.2d at 871; *A.Y. McDonald Indus., Inc.*, 475 N.W.2d at 619; *North Star Mut. Ins. Co.*, 402 N.W.2d at 454; *Rich v. Dyna Technology, Inc.*, 204 N.W.2d 867, 872 (Iowa 1973) ("Where insurance contracts are ambiguous, require interpretation, or are susceptible to equally proper constructions, the court will adopt the construction most favorable to the insured."); *The Travelers v. Mays*, 434 N.W.2d 133, 134 (Iowa Ct. App. 1988) (quoting *Rich*). The reason underlying this rule is that insurance contracts are contracts of adhesion. *Joffer*, 574 N.W.2d at 306; *Cincinnati Ins. Co.*, 522 N.W.2d at 839; *Jensen*, 510 N.W.2d at 871; *A.Y. McDonald Indus., Inc.*, 475 N.W.2d at 619. Again, however, this rule applies only when the terms of the policy are ambiguous or unclear. *Joffer*, 574 N.W.2d at 307; *Farm & City Ins. Co.*, 509 N.W.2d at 490-91.

When interpreting insurance policies, a court must "'seek to ascertain from its words the intent of the insurer and insured at the time the policy was sold.'" *Jensen*, 510 N.W.2d at 871 (quoting *Grinnell Mut. Reinsurance Co. v.*

Voeltz, 431 N.W.2d 783, 785 (Iowa 1988).[4] Thus, in analyzing the definition of "property damage" as it reads in the umbrella policy at issue in this litigation, the question the court must resolve is, "Are the terms of the policy, i.e. 'property damage,' susceptible to two or more meanings?" With this question in mind, the court proceeds to an analysis of the parties' arguments regarding the definition of "property damage."

C. "Property Damage" Under National Union Umbrella Policy

In Terra's umbrella policy with National Union, the pertinent liability coverage provision provides coverage for "property damage," which is defined as "Physical injury to tangible property, including all resulting loss of use of that property." Terra claims the damages alleged in the underlying English lawsuits constitute "property damage" and are covered under its umbrella policy with National Union. National Union, on the other hand, asserts that the

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[4] Under Iowa law, the court, not the jury, has the duty to construe contracts. *AMCO Ins. Co. v. Rossman*, 518 N.W.2d 333, 334 (Iowa 1994); *Jensen*, 510 N.W.2d at 871; *Grinnell Mut. Reinsurance Co. v. Voeltz*, 431 N.W.2d 783, 785 (Iowa 1988). Although interpreting the meaning of words in an insurance policy is most often an issue of law for the court to decide, the interpretation becomes a question of fact where the interpretation depends on "extrinsic evidence or on a choice among reasonable inferences from extrinsic evidence." *Jensen*, 510 N.W.2d at 871;*Voeltz*, 431 N.W.2d at 785. Extrinsic evidence refers to evidence other than the words of the policy. *Jensen*, 510 N.W.2d at 871; *Voeltz*, 431 N.W.2d at 785. Although the parties may disagree on the meaning of a term, that does not establish that the term is ambiguous so as to cause an interpretation of the contract against the maker. *AMCO Ins. Co.*, 518 N.W.2d at 334.

inclusion of the benzene in Terra's carbon dioxide did not cause physical injury to a tangible property. Thus, it argues that there is no covered "property damage" as that term is defined in the policy. Both parties cite the court to lines of authority which they claim buttress their position. The court will begin its analysis of the definition of "property damage" and whether the claims in the underlying English lawsuits fit within this definition to trigger coverage under Terra's umbrella policy by looking at the applicable law in Iowa and at analogous cases in other states and in other jurisdictions.

1. Iowa law

Under Iowa law, the case most closely addressing the issue raised by the parties, whether the integration of contaminated material into a product constitutes "property damage" as defined by the policy, is the Iowa Court of Appeals's decision in *Kartridg Pak Co. v. Travelers Indem. Co.*, 425 N.W.2d 687 (Iowa Ct. App. 1988). In *Kartridg Pak Co.*, an insurer claimed it did not have a duty to defend its insured, Kartridg Pak Company ("Kartridg Pak"), in a lawsuit filed by Iowa Meat Fabricators, Inc. ("Iowa Meat"), in that its general liability policy did not provide coverage for any of the claims asserted by Iowa Meat in the underlying lawsuit. *Kartridg Pak Co.*, 425 N.W.2d at 688. In the underlying lawsuit, Iowa Meat asserted claims of breach of contract and breach of express and implied warranties against Kartridg Pak. *Id.* at 689. Specifically, Iowa Meat alleged that a mechanical deboner, which it leased from Kartridg Pak, did not perform as promised, resulting in too much bone being "left in the meat to allow it under government regulations to be sold for human consumption." *Id.* at 689. Kartridg Pak contended that the diminished

value of the meat created the requisite "property damage" under the policy, and thus, its insurer had an obligation to defend Kartridg Pak in the underlying lawsuit. *Id.* The general liability policy provided the following definition of "property damage":

> (1) [P]hysical injury to or destruction of tangible property which occurs during the policy period, including the loss of use thereof at any time resulting therefrom, or
>
> (2) [L]oss of use of tangible property which has not been physically injured or destroyed provided such loss of use is caused by an occurrence during the policy period.

Id.

The Iowa Court of Appeals found this alleged diminution in value did not constitute "property damage," and noted that "although the failure to sufficiently separate the meat and bone allegedly diminished the value of the backbones, it did not physically injure the product. Thus, this failure cannot support coverage for damages allegedly caused by it." *Id.* at 690. In arriving at this conclusion, the court noted that other courts have found that intangible losses, such as loss of use or diminution of value, are "property damage;" however, those decisions had interpreted policy language defining "property damage" as "injury to tangible property," rather than "physical injury to tangible property." *Id.* at 689 (quoting *American Home Assur. Co. v. Libbey-Owens-Ford Co.*, 786 F.2d 22, 25 (1st Cir. 1986) (citations omitted)). The Iowa Court of Appeals went on to note that where courts have interpreted "more recent policies in which property damage is defined as 'physical' injury to tangible property, such courts have held

that intangible damages, such as diminution in value, are not considered property damage." *Id.* (quoting *American Home Assur. Co.*, 786 F.2d at 25, in turn, citing *Wyoming Sawmills, Inc. v. Transportation Ins. Co.*, 282 Or. 401, 578 P.2d 1253 (1978), and *Federated Mut. Ins. Co. v. Concrete Units, Inc.*, 363 N.W.2d 751, 757 (Minn.1985)). The Iowa Court of Appeals further recognized that:

> the critical difference in policy language is the result of a 1973 revision of the Comprehensive Liability Policy, used by most insurance companies, which expressly added the modifier "physical" injury to the definition of "property damage" in order to restrict recovery for intangible losses. . . . Under this policy language, some physical injury to tangible property must be shown in order to trigger coverage.

Kartridg Pak Co., 425 N.W.2d at 689 (quoting *American Home Assur. Co.*, 786 F.2d at 25). The court determined the policy in that case reflects "this change in the definition of property damage" and found that the requirement in that policy of "physical injury to or destruction to tangible property" was clear and unambiguous. *Id.* at 690. Thus, the Iowa Court of Appeals concluded that diminution in value that resulted from the inclusion of excess bone did not constitute physical injury to or destruction of tangible property. *Id.*

It is apparent that the clause defining "property damage" in the National Union policy is nearly identical to the clause in *Kartridg Pak* in that the National Union policy defines "property damage," in part, as "physical damage to tangible property . . ." *Kartridg Pak* indicates that property damage may be defined as physical injury, damage, or destruction to tangible property. *Id.* at 690. In

addition, because the definition of property damage included the modifier "physical" before injury, damage, or destruction, the Iowa appellate court found that "physical" damage, injury, or destruction to tangible property is required in order to trigger coverage under an insurance policy and an insurer's duty to defend. *See Kartridg Pak Co.*, 425 N.W.2d at 690 (intangible losses, such as diminution in value, do not constitute physical injury to or destruction of tangible property).[5]

While at first glance the *Kartridg Pak* decision would appear to be compelling authority in analyzing the property damage clause in the umbrella policy at issue in this litigation, closer examination of the decision, however, demonstrates that it is not precisely on point. While too much bone being left in the meat in *Kartridg Pak* is analogous to the factual situation here with benzene being left in the carbon dioxide, a significant difference lies in

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[5] Previously, where the policy in question defined "property damage" either in sum or in part without the modifier "physical" before damage, injury, or destruction, Iowa courts have recognized insurance coverage for loss of use of tangible property that was not physically damaged. *See, e.g., Ellsworth-William Coop. Co. v. United Fire & Casualty Co.*, 478 N.W.2d 77, 81-82 (Iowa Ct. App. 1991) (loss of use of undamaged grain bins was covered loss of use of tangible property where definition of property damage included "loss of use of tangible property which has not been physically injured or destroyed . . . ."); *First Newton Nat'l Bank v. General Casualty Co. of Wis.*, 426 N.W.2d 618, 626-27 (Iowa 1988) (where multi-peril policy provided two alternative definitions of property damage, one of which required "loss of use of tangible property which has not been physically injured or destroyed . . . ," and umbrella policy defined "property damage" as an "injury to or destruction of tangible property," loss of property and loss of profits from farming operations sufficed to meet the required definitions of "property damage" under both policies in order to trigger coverage).

the fact that the contaminated meat in *Kartridg Pak* was not incorporated in another product. This accounts for the reason why the insured in *Kartridg Pak* was claiming that diminution in value constituted physical injury. Here, on the other hand, Terra is not seeking to recover under its umbrella policy for the carbon dioxide that had been contaminated with benzene, which would be the factually equivalent situation that the Iowa Court of Appeals faced in *Kartridg Pak*. Rather, Terra is seeking coverage for the damage done when its contaminated carbon dioxide was incorporated into beverages. Thus, the issue before the court here is not the same one that was decided by the Iowa Court of Appeals in *Kartridg Pak*. The court, therefore, concludes that Iowa courts have not directly addressed the issue before the court in this case, whether the integration of contaminated material into another product constitutes "property damage." As a result, the court turns to an examination of case law in other jurisdictions in order to address this issue.

2. Other jurisdictions

In addition to the *Kartridg Pak Co.* decision, National Union relies on a line of cases from other jurisdictions holding that the diminution in the value of a product that results from the inclusion of a defective part does not constitute property damage. *See Esicorp, Inc. v. Liberty Mut. Ins. Co.*, 266 F.3d 859, 862-63 (8th Cir. 2001); *Travelers Ins. Co. v. Eljer Mfg., Inc.*, 757 N.E.2d 481, 496 (Illinois 2001); *Aetna Life & Cas. v. Patrick Indust., Inc.*, 645 N.E.2d 656, 661-62 (Ind. Ct. App. 1995). Terra, on the other hand, relies on a line of cases for the proposition that the inclusion of contaminated or potentially hazardous material in a product constitutes property damage. *See*

Shade Foods, Inc. v. Innovative Prods. Sales & Mktg., Inc., 93 Cal. Rptr.2d 364, 376 (Cal. Ct. App. 2000); *Aetna Cas. & Surety Co. v. Ply Gem Indus., Inc.*, 778 A.2d 1132, 1137 (N.J. Super. Ct. App. Div. 2001). Therefore, the court turns to an examination of these lines of authorities.

In the Eighth Circuit Court of Appeals's decision in *Esicorp*, the insured's assignee brought a lawsuit against the defendant insurer for breach of the duty to defend the insured under a CGL policy issued by defendant insurer. *Esicorp, Inc. v. Liberty Mut. Ins. Co.*, 266 F.3d at 861. In the underlying action against the insured, a third party brought a claim for losses arising out of the need to repair defective pipe welds, which were incorporated into a pipe system, that the insured's testing failed to discover. *Id.* The insurance policy at issue in *Esicorp* contained virtually the same definition of property damage as National Union's umbrella policy does here. The Eighth Circuit Court of Appeals, in addressing the question of whether the damages claimed by the plaintiff were covered under the insurance policy, determined that the issue hinged on the terms "'damages' . . . because of 'property damage'" and "physical injury to tangible property." *Id.* at 862. The court observed: "It is significant that the defectively welded pipe sections did not collapse or burst or otherwise cause accidental injury to surrounding property as a result of [the insured's] negligent inspection." *Id.* The insured, however, relied on the incorporation theory, arguing that "the incorporation of the defectively welded pipe sections into the partially completed pipe system was covered property damage, and therefore all direct and consequential costs resulting from that damage are covered losses." *Id.* The Eighth Circuit Court of Appeals disagreed and determined that the Missouri Supreme Court would reject

the incorporation theory; concluding that merely integrating defective pipe into a partially completed pipe system did not constitute property damage. *Id.* The court of appeals found that the insurance policy's definition of "property damage" requires some "physical injury to tangible property" and that the majority of the plaintiff's losses, including all of the repairs to the shop welds, were not covered because the property was not physically injured. *Id.* The court concluded that these expenses "were direct and consequential repair costs, which were not covered property damage," *Id.* at 864.

The facts here are distinguishable from *Esicorp* in that the defectively welded pipes in *Esicorp* could be individually repaired and had not damaged the other parts of the hydroelectric plant. Here, in contrast, the contaminated carbon dioxide could not be removed from the beverages and, as a result, the entire beverage was rendered unsuitable for human consumption due to the incorporation of a known carcinogen into the beverage.

In *Travelers Ins. Co. v. Eljer Mfg, Inc.*, 757 N.E.2d 481 (Ill. 2001), an insurer filed declaratory judgment actions in which it sought declarations regarding its obligations to indemnify its insureds in underlying products liability claims arising out of the failure of a residential plumbing system. *Id.* at 486. The insurer argued that "property damage" does not occur until a particular claimant's plumbing system failed and leaked, causing water damage to the claimant's property. The insureds argued that "property damage" within the meaning of the policies took place at the time of the installation of the allegedly defective system. The court found that "under its plain and ordinary meaning, the term 'physical injury to tangible property' unambiguously connotes damage to tangible

property causing an alteration in appearance, shape, color or in other material dimension." *Id.* at 502. Based on that definition, the court rejected the argument that the mere installation of a plumbing system into a structure constitutes "property damage." *Id.*[6] The *Eljer* decision is factually opposite of what the court confronts here. Here, in contrast, the contaminated carbon dioxide has already had an effect upon the beverages, infecting the beverages with a known carcinogen and rendering them unsuitable for human consumption.

Finally, in *Aetna Life & Cas. v. Patrick Indus.*, 645 N.E.2d 656 (Ind. Ct. App. 1995), the insured bought particle board from a supplier and glued a vinyl covering onto it. The insured then sold the particle board to a manufacturer of camper trailers who installed the particle board in its products. The vinyl covering began peeling off the installed particle board. The manufacturer produced

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[6] Prior to the Illinois Supreme Court's decision in *Eljer*, the Seventh Circuit Court of Appeals reached the opposite conclusion in its decision in *Eljer Mfg., Inc. v. Liberty Mut. Ins. Co.*, 972 F.2d 805 (7th Cir. 1992), *cert. denied*, 507 U.S. 1005 (1993), a case which also concerned the same plumbing system. The insurer involved in the particular suits at issue in the Seventh Circuit Court of Appeals's *Eljer* decision contended that coverage for such claims was not triggered until a system actually leaked, causing damage to the rest of the residence. *Id.* at 808. The Seventh Circuit Court of Appeals held, pursuant to the very policy language concerning property damage which is at issue in this case, that "the drafting history of the property damage clause, and the probable understanding of the parties to liability insurance contracts, persuade us that incorporation of a defective product into another product inflicts physical injury in the relevant sense on the latter at the moment of incorporation." *Id.* at 814. In its *Eljer* decision, the Illinois Supreme Court expressly rejected the reasoning of the Seventh Circuit Court of Appeals in its *Eljer* decision. *Eljer Mfg. Co.*, 757 N.E.2d at 497.

non-defective replacements and replaced the defective products. The insured settled with the manufacturer and then sought coverage from its insurer under a standard CGL policy which defines "property damage" in the same words as does the policy at issue here. The insured argued that the property damage clause provided coverage when the insured supplied defective components to a third party which decreased the value of the final product. *Id.* at 657. The Indiana Court of Appeals noted that previous property damage clauses had been held to provide coverage for claims for diminution of value where the policies' definition read slightly differently: "injury to or destruction of tangible property." *Id.* By specifically qualifying that definition by placing the modifier "physical" before "injury," the Indiana court found that the later definition was intended to exclude coverage for claims " 'such as depreciation in value.' " *Id.* at 660 (quoting *Wyoming Sawmills, Inc. v. Transportation Ins. Co.*, 578 P.2d 1253, 1256 (Or. 1978)). The court concluded that: "The coverage is for tort liability for physical damages to others and not for contractual liability of the insured for economic loss because the product or completed work is not that for which the damaged person bargained." *Id.* (citations omitted). Thus, the court declined to hold that "physical injury will be deemed to occur every time a defective component is integrated into another's tangible property." *Id.* at 662.

The facts here are distinguishable from those in the *Patrick* decision. As the court noted above in its discussion of the decision in *Esicorp*, the end product in *Patrick*, the travel trailers, could be individually repaired by removal of the defective product. Here, in comparison, contaminated carbon dioxide could not be removed from the beverages into which it had been incorporated and, as a

result, the entire beverage was rendered unsuitable for human consumption.

While under the *Esicorp-Eljer-Patrick* line of authorities one cannot recover for property damage without physical damage or destruction to tangible property, another line of authorities have arrived at the opposite conclusion with respect to the inclusion of potentially dangerous material within a product. The California Court of Appeals's decision in *Shade Foods, Inc. v. Innovative Products Sales & Marketing, Inc.*, 93 Cal. Rptr.2d 364 (Cal. Ct. App. 2000) is illustrative of this line of authorities. In *Shade Foods*, a processor supplied almonds that were contaminated with wood splinters. The almond product was used in almond clusters in cereal. Because the nut clusters were composed of congealed syrups and nuts contaminated by wood splinters, the product could not be "somehow deconstructed to remove the injurious splinters and then recombined for their original use." *Id.* at 377. The court of appeals found that loss resulting from the physical linkage of the contaminated nut product resulted in property damage to a third party's product. *Id.* "While the distinction may sometimes be a fine one to draw, we see no difficulty in finding property damage where a potentially injurious material in a product causes loss to other products with which it is incorporated." *Id.* at 376-77. Thus, the wood splinters that were so integrated in the physical composition of the nut clusters caused property damage to the third party's product. The analysis employed in *Shade Foods* would produce the same conclusion in the case of benzene contaminated carbon dioxide being incorporated into carbonated beverages – that the carbon dioxide caused product damage to the beverage products.

In arriving at its decision in *Shade Foods*, the California Court of Appeals relied on a prior decision in *Armstrong World Indus., Inc. v. Aetna Cas. & Surety Co.*, 52 Cal. Rptr. 2d 690 (Cal. Ct. App. 1996). In *Armstrong*, the appeals court rejected the insurers' reliance on the rule that physical incorporation of a defective product into another does not constitute property damage unless there is physical harm to the whole. *Id.* at 734. The court of appeals noted that the presence of asbestos causes injury to a building "because the potentially hazardous material is physically touching and linked with the building and not merely contained within it, the injury is physical even without a release of toxic substances into the building's air supply." *Id.* The court of appeals concluded "that the alleged injury from installation of [asbestos-containing building material] qualifies as 'physical injury to . . . tangible property' " under the terms of the standard-form policy. *Id.*

Similarly, in *Johnson v. Studyvin*, 828 F. Supp. 877, 883 (D. Kan. 1993), another case involving an installer of asbestos-containing products, the installer placed a spray-on, asbestos-containing textured ceiling in a house and a subsequent owner of the house discovered that the ceiling texture contained the asbestos. Alleging both bodily injury and property damage, the subsequent owner sued the contractor, which sought coverage under the policies of a former insurer. In determining whether there was property damage at the point that the ceiling materials were installed, the district court concluded that "at the moment when a defective product, such as a ceiling texture which is hazardous because it contains asbestos, is attached to some property in a manner that makes it not easily removed, that property is physically injured." *Id.*

This court also notes that in its *Eljer* decision, the Illinois Supreme Court distinguished one of its previous cases involving the installation of asbestos contaminated materials, *United States Fidelity & Guar. Co. v. Wilkin Insulation Co.*, 578 N.E.2d 926 (Ill. 1991), from *Eljer*. *Eljer*, 757 N.E.2d at 498. In *Wilkin*, the Illinois Supreme Court held that "asbestos fiber contamination constitutes physical injury to tangible property, i.e., the buildings and their contents." *Wilkin*, 578 N.E.2d at 931. The court explained that the insured property was "physically" injured as a result of the presence of toxic asbestos fibers within the structures, as "the buildings and their contents (e.g., carpets, upholstery, drapes, etc.) are virtually contaminated or impregnated with asbestos fibers, the presence of which poses a serious health hazard to the human occupants." *Id.* Thus, the court concluded that "the contamination of the buildings and their contents" due to the continuous release of these toxins constituted "physical injury" under the policies. *Id.* at 932.

The court finds the decisions in *Shade Foods*, *Armstrong*, *Johnson*, and *Wilkin*, more closely resemble the situation in this case, for in each of these cases, the courts concluded that a product was damaged where potentially hazardous materials were incorporated into it. *Shade Foods*, 93 Cal. Rptr.2d at 377; *Armstrong World Indus., Inc.*, 52 Cal. Rptr. 2d at 734; *Johnson*, 828 F. Supp. at 883; *Wilkin*, 578 N.E.2d at 932.

3. Analysis of National Union's umbrella policy

The National Union Policy defines "property damage" in relevant part as: "Physical injury to tangible property,

including all resulting loss of use of that property." Terra App. Tab 4 at A-105. The phrase "physical injury to tangible property," however, is not defined in the umbrella policy. Nonetheless, the court finds at the terms to be unambiguous. Thus, the court concludes that the Iowa Supreme Court would apply the natural and ordinary meaning of the language of the policy. *See Continental Ins. Co. v. Bones*, 596 N.W.2d 557, 557 (Iowa 1999); *Werner's Inc. v. Grinnell Mut. Reinsurance Co.*, 477 N.W.2d 868, 871 (Iowa Ct. App. 1991). In *Eljer*, the Illinois Supreme Court stated that "under its plain and ordinary meaning, the term 'physical injury to tangible property' unambiguously connotes damage to tangible property causing an alteration in appearance, shape, color or in other material dimension." *Eljer*, 757 N.E.2d at 502. The court concludes that the Iowa Supreme Court would reach a similar conclusion and, therefore, adopts that definition.

National Union argues that under this definition of "physical injury to tangible property" no property damage occurred because the carbon dioxide did not alter the appearance, shape or color of the chemicals making up the beverages into which it was assimilated. This argument, however, leaves open the question of whether the carbon dioxide laced with benzene altered the beverages in some "other material dimension." While National Union argues that carbon dioxide did not alter the beverage in some other material dimension, the court finds that it did. The carbon dioxide adulterated with a known carcinogen, benzene, rendered the beverages useless for its intended purpose, human consumption. This purpose could not be restored because removal of the benzene was impossible. Thus, like the wood laced nut clusters in *Shade Foods*, and the asbestos intertwined building products in *Armstrong*,

Johnson, and *Wilkin*, the court concludes that the beverages were damaged by the introduction of potentially injurious material, the carbon dioxide containing a known carcinogen.[7]

D. "Occurrence" Under National Union Umbrella Policy

National Union also argues that there is no coverage under its umbrella policy because Terra cannot demonstrate that the property damage was caused by an occurrence. The National Union Policy defines an "occurrence" with respect to property damage as follows:

> 1. As respects **Bodily Injury** or **Property Damage**, an accident, including continuous or repeated exposure to conditions, which results in Bodily Injury or Property Damage neither expected nor intended from the standpoint of the Insured. All such exposure to substantially the same general conditions shall be considered arising out of one Occurrence.

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[7] The court notes that National Union also relies on Justice Tomlinson's conclusion that Messer could not invoke the limitation of liability clause in its contract with Thomas Hardy Packaging, the bottler in the *Bircardi-Martini* case, because Messer had not caused "direct physical damage to property." The court finds this reliance on Justice Tomlinson's decision to be misplaced. The limitation of liability in Messer's contract required "direct physical damage to property," a phrase which does not appear in the umbrella policy's definition of property damage. Thus, Justice Tomlison's interpretation of Messer's limitation of liability clause is based on a definition of property damage distinct from the umbrella policy before this court.

Terra App. Tab 4 at A-104. The term "accident" is left undefined in the policy.

The Eighth Circuit Court of Appeals observed in applying Iowa law that:

> when "accident" is used in the definition of an "occurrence," but left undefined in the policy, the ordinary meaning to be given the term is "an undesigned, sudden, and unexpected event, usually of an afflictive or unfortunate character, and often accompanied by a manifestation of force. . . . [The term] clearly implies a misfortune with concomitant damage to a victim, and not the negligence which eventually results in that misfortune." [*Pursell Constr., Inc. v. Hawkeye-Sec. Ins. Co.*], 596 N.W.2d at 70 [(Iowa 1999)] (quoting *Central Bearings Co. v. Wolverine Ins. Co.*, 179 N.W.2d 443, 448 (Iowa 1970)).

Norwalk Ready Mixed Concrete, Inc. v. Travelers Ins. Co., 246 F.3d 1132, 1136-37 (8th Cir. 2001).

The court notes that courts have held that where an insured unintentionally sells a defective product that is incorporated into a third-party's finished product, the resulting impairment to the third-party's product is an "occurrence." *See Maryland Casualty Co. v. W.R. Grace & Co.*, 23 F.3d 617, 624 (2d Cir. 1993); *Aetna Casualty & Surety Co. v. General Time Corp.*, 704 F.2d 80 (2d Cir. 1983); *Chubb Ins. Co. of N.J. v. Hartford Fire Ins. Co.*, No. 97 CIV. 6935 LAP, 1999 WL 760206, at *9 (S.D.N.Y. Sept. 27, 1999), *affirmed*, 229 F.3d 1135 (2d Cir. 2000); *Union Carbide Corp. v. Travelers Indemnity Co.*, 399 F. Supp. 12, 20 (W.D. Pa. 1975); *Sturges Mfg. Co. v. Utica Mutual Ins. Co.*, 37 N.Y.2d 69, 371 N.Y.S.2d 444 (1975); *Thomas J. Lipton, Inc. v. Liberty Mutual Ins. Co.*, 34 N.Y.2d 356, 357

N.Y.S.2d 705 (1974). This is precisely what occurred in this case, with Terra unknowingly selling carbon dioxide laced with benzene to the Bottlers as a result of malfunction at its plant thereby permitting the tainted carbon dioxide to be subsequently incorporated into beverages destined for human consumption.

A case on point presenting virtually indistinguishable facts is the decision in *Chubb Ins. Co.*, No. 97 CIV. 6935 LAP, 1999 WL 760206. In *Chubb*, the insurer was found to be obligated to defend the insureds in actions brought against them by Coca-Cola Foods and Tree Top, Inc. for failing to supply one-hundred percent pure apple juice concentrate as per contract specifications. *Id.* at *2. The insurer argued, as does National Union here, that it had no obligation to defend its insureds because the suits were for breach of contract and breach of warranty, and that a breach of contract or warranty could not constitute a covered "occurrence" within the meaning of a commercial general liability insurance policy. *Id.* The district court disagreed and concluded a breach of contract or warranty can be an "occurrence" if, as a result of the breach, property sold by the insured to a third party, which was then incorporated into other property belonging to the third party, caused damage to this other property. *Id.* at *8.

Similarly, in *Aetna Casualty & Surety Co. v. General Time Corp.*, 704 F.2d 80 (2d Cir. 1983), the Second Circuit Court of Appeals affirmed the district court's finding that where the insured neither intended nor expected its electric motors to malfunction, the damage caused when the electric motors, which were incorporated into a third party's product, malfunctioned was an "occurrence" within the meaning of a general liability policy and an umbrella policy. *See General Time Corp.*, 704 F.2d at 83. Here, the

risk Terra intended to be insured against was the possibility that its products, once completed and sold, would cause bodily injury or damage to property other than the product itself, and for which Terra might be found liable. This is precisely what occurred here. Thus, the court concludes that events giving rise to the underlying actions constitute an occurrence under the terms of the umbrella policy.[8]

III. CONCLUSION

The court concludes that the adulteration of Terra's carbon dioxide with benzene which was then sold for incorporation into carbonated beverages destined for human consumption was an "occurrence" within the terms of the National Union umbrella policy and that this occurrence resulted in "property damage" when the adulterated carbon dioxide was incorporated into the beverages making them unsuitable for human consumption. Therefore, the court denies plaintiff National Union's Motion For Summary Judgment and grants defendant Terra's Motion For Summary Judgment. Terra shall be reimbursed by National Union for the damages that Terra

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[8] National Union also denies liability based on its contention that the underlying claims do not involve tortuous conduct. National Union's umbrella policy, however, does not limit its coverage solely to tort claims. Rather, the policy requires National Union to:

> pay on behalf of the Insured those sums in excess of the Retained Limit that the Insured becomes legally obligated to pay by reason of liability imposed by law or assumed by the Insured under an Insured Contract because of . . . Property Damage . . . that takes place during the Policy Period and is caused by an Occurrence happening anywhere in the world.

Terra App. Tab 4 at A-100.

has paid with respect to the *Bicardi-Martini* judgement. The court further directs that National Union has a duty under its umbrella policy with Terra to continue to pay for Terra's defense of all benzene claims as well as indemnifying Terra against any judgment or settlement that Terra is required to pay as a result of the benzene contamination.

Like my English colleague in the underlying litigation, Justice Tomlinson, I find the conclusions here are reached "On balance and not without hesitation." *Bicardi-Martini* Judgment, Case 1999 Folio No. 1198 at ¶29, Terra App. Tab 7 at A-272. Given the closeness and lack of definitive authority on the issues presented, the nearly equal strength of legal arguments by both parties, and the substantial amount of money at stake, this court is mindful that this decision will not be nor should it be the last judicial word in this litigation. The parties and this court will all benefit from the wisdom and guidance of the Unite[d] States Court of Appeals for the Eighth Circuit – the inevitable next stop for this case. Likewise, the Eighth Circuit will benefit in its task from the outstanding briefing and arguments of counsel.

IT IS SO ORDERED.

DATED this 16th day of August, 2002.

/s/ Mark W. Bennett
MARK W. BENNETT
CHIEF JUDGE, U. S. DISTRICT COURT
NORTHERN DISTRICT OF IOWA

UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT

No. 02-3280

National Union Fire Insurance, etc.,	* Order Denying Petition
	* for Rehearing and for
Appellant,	* Rehearing En Banc
	*
v.	*
	*
Terra Industries, Inc., et al,	*
	*
Appellees.	*

The petition for rehearing en banc is denied. The petition for rehearing by the panel is also denied.

(5128-010199)

November 20, 2003

Order Entered at the Direction of the Court:

Clerk, U.S. Court of Appeals, Eighth Circuit